United States Court of Appeals
for the Second Circuit

BRIEF FOR APPELLANT

74-2591

To be argued by
Stanley Nemser

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

B/

No. 74-2591

P/S

ALBERT KAUFMANN,

Plaintiff-Appellant,

-against-

MARY WELLS LAWRENCE, CHARLES MOSS, RICHARD T. O'REILLY, JOHN V. BURNS, FRANK G. COLNAR, FREDERICK L. JACOBS, BARRY E. LOUGHRANE, MARTIN STERN, STANLEY G. DRAGOTI, CATHARINE GIBSON, F. DONALD CHALLIS and WELLS, RICH, GREENE, INC.,

Defendants-Appellees,

and

WARREN J. KRATKY, ARNOLD M. GRANT, TROY V. POST and EMILIO PUCCI,

Defendants.

On Appeal From the United States District Court for the Southern District of New York

BRIEF FOR PLAINTIFF-APPELLANT

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BRIEF FOR PLAINTIFF-APPELLANT

PRELIMINARY STATEMENT

This is an appeal from an Order (735a)*, dated and filed December 5, 1974, of District Judge Robert L. Carter, pursuant to a decision (720a), denying plaintiff's motion for

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* The Joint Appendix is divided into Part I consisting of two Volumes, and Part II containing the in camera portion of the Record.

a preliminary injunction and vacating the restraining order theretofore granted. The decision is not as yet officially reported. It is reported in [Current] CCH Fed. Sec. L. Rep., ¶94,908.

This litigation, of national significance and involving the protection of public investors and the protection of the integrity of securities markets, is directed against the efforts of the 12 directors [who own in the aggregate 13.9% (226,850 shares) of the outstanding common stock] of the defendant Wells, Rich, Greene, Inc. ("WRG"), an advertising agency, to "freeze-out" the more than 2,000 public stockholders of WRG who own 83.7% (1,366,806 shares) of the outstanding WRG common stock. [The balance of 2.4% (38,202 shares) of the outstanding common stock is owned by certain officers of WRG who are not directors.] The method initially used in the scheme to "go private" is an Exchange Offer of WRG, pursuant to which it has offered to purchase 1,405,008 shares of its own common stock, that is, all of WRG's outstanding common except the 226,850 shares owned by its directors who have "agreed" not to tender. The common stock of WRG is listed on the New York Stock Exchange.

The action is brought under Section 10(b) [15 U.S.C. §78j(b)] and Section 14(e) [15 U.S.C. §78(e)] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 [17 C.F.R. 240.10b-5] promulgated thereunder, and common law principles. The District Court has found that it has jurisdiction pursuant to Section 27 [15 U.S.C. §78aa] of the Exchange Act (721a).

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. Does the plan of the defendants to "freeze out" the public stockholders of WRG and to cause WRG to "go private", and the acts taken in the implementation thereof, constitute a "device, scheme, or artifice to defraud" and "acts, practices, or a course of business operating as a fraud and deceit" upon the public stockholders of WRG, in violation of Section 10(b) and Rule 10b-5?

2. Did the defendants engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with the Exchange Offer, and the requests or invitations for tenders of WRG common stock thereunder, in violation of Sections 10(b) and 14(e) and Rule 10b-5?

3. Did the defendants make any untrue statement of material fact or omit to state a material fact in connection with the plan of the defendants to "freeze out" the public stockholders of WRG and to cause WRG to "go private", and the implementation thereof, including the Exchange Offer and the requests or invitation for tenders of WRG common stock thereunder, in violation of Sections 10(b) and 14(e) and Rule 10b-5?

4. Does the plan of the defendants to "freeze out" the public stockholders of WRG and to cause WRG to "go private", and the acts taken in the implementation thereof, contravene the national public interest and the Congressional policy reflected in the Exchange Act to protect the public investors, to require full disclosure, and to maintain the integrity of

the securities markets?

5. Did the Court below err in its legal conclusions that the Federal securities laws do not reach the acts involved in connection with the plan to "freeze out" the public stockholders of WRG and to cause WRG to "go private"?

6. Did the Court below misapply the applicable "materiality" standard in reaching its ultimate finding that claimed misrepresentations and omissions were not material?

7. Did the Court below err in its legal conclusions that per se a corporate effort to free itself from federal regulations, and "profit-making" or "shrewd business tactics" designed to benefit insiders, in connection with the "freeze out" of the public stockholders of WRG and the"going private" of WRG, were beyond the pale of Sections 10(b) and 14(e)?

8. Did the Court below misapply the applicable preliminary injunction standards, in the context of both the Record before it and its erroneous conclusions of law and erroneous ultimate findings of fact?

9. Did the Court below err in its conclusions that the plaintiff and the class have an adequate remedy at law and that monetary damages will suffice to make them whole?

10. Did the Court below err in not granting the preliminary injunctive relief requested by the plaintiff or such other mode of injunctive relief as equity may require in the premises?

These issues are framed around the misinterpretations by the Court below of the anti-fraud provisions of the Exchange Act which, plaintiff submits, led to its erroneous conclusions of law and erroneous findings of ultimate facts and its consequent denial of the preliminary injunction. Indeed, based upon certain of the Court's findings of basic facts and upon a correct application of Sections 10(b) and 14(e) and Rule 10b-5, the Court should have, and undoubtedly would have, granted preliminary injunctive relief.

The Court below did not take cognizance of the principle that once a deceptive or manipulative act attaches to 10(b) and Rule 10b-5 in connection with a purchase or sale of securities, or attaches to 14(e) in connection with a tender offer, the entire developing body of Federal corporation law comes into operation (including breaches of fiduciary duty, fair dealing, conflicts of interest, and mismanagement) as it relates to the transaction or series of transactions involved in or connected with the particular misconduct involved. <u>Superintendent of Insurance v. Bankers Life & Casualty Co.</u>, 404 U.S. 6, 92 S.Ct. 165, 30 L.ed.2d 128 (1971); <u>Schlick v. Penn-Dixie Cement Corp.,</u> [Current] CCH Fed.Sec.L.Rep., ¶94,853 (2nd Cir. 1974); <u>S.E.C. v. Capital Gains Bureau, Inc. 375 U.S. 180</u> (1963); <u>McClure v. Borne Chemical Company, Inc.</u>, 292 F.2d 824 (3rd Cir. 1961), cert. denied, 368 U.S. 939 (1961). See also, Jacobs, "<u>The Role of Securities Exchange Act Rule 10b-5 In the Regulation of Corporate Management</u>, 59 Corn. L. Rev. 27, 30-40 (1973).

The Court below interpreted the scope of 10(b), 14(e), and Rule 10b-5 very narrowly. Relying exclusively on this phase (734-735a) on Popkin v. Bishop, 464 F.2d 714, 721 (2nd Cir. 1971), involving a rare situation not at all involved here, the Court below completely ignored Rule 10b-5(a) - "device, scheme, or artifice to defraud", and also completely ignored Rule 10b-5(c) - "act, practice, or course of business which operates or would operate as a fraud or deceit". That those subsections of Rule 10b-5 are independently viable is manifest: Superintendent of Insurance v. Bankers Life & Casualty Co., supra; Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970); Schlick v. Penn-Dixie Cement Corp., supra; Schoenbaum v. Firstbrook, 405 F.2d 215 (2nd Cir. 1968)(en banc), cert. denied, 395 U.S. 906 (1969).

In fact, in the recent decision of Chief Judge Ritter, in Albright v. Bergendahl, Civil No. C74-135 (D.Utah, Sept. 5, 1974), the Court there struck down a "freeze out" and "going private" situation expressly under Rule 10b-5, subdivs. (a) and (c), and granted summary judgment. For the convenience of the Court herein, there is annexed to this Brief, as Addendum A, a copy of the Albright decision, since the decision is not reported.

The Court below also misapplied the standard of "materiality" to the misrepresentations and omissions involved here. In the context of the undisputed facts and the Court's findings of basic facts, and the precedent authorities, it is submitted, as will be shown in this Brief, that such misrepresentations and

omissions were materially false and misleading under the correct application of the standard, and as a matter of law. Sonesta International Hotels Corp. v. Wellington Associates, 483 F.2d 247 (2nd Cir. 1973); S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833 (2nd Cir. 1968)(en banc), cert. denied, 394 U.S. 976 (1969); Gould v. American Hawaiian Steamship Company, 319 F.Supp. 795, 803 (D.Del. 1970).

The issues presented for review will be discussed in detail, infra, as they relate to the particular facts and the applicable law involved.

STATEMENT OF THE CASE

A. NATURE OF THE ACTION

This is a class action brought on behalf of the plaintiff and all other common stockholders of WRG similarly situated (8a). At the time of the commencement of the suit on November 19, 1974 (2a), the plaintiff owned 100 shares of WRG common which he had purchased on March 8, 1974 (5a). The defendants are WRG, all of its directors (some of whom are also the principal executive officers of WRG), and certain of its other officers who are not directors (5-6a). The defendant Mary Wells Lawrence ("Lawrence") is Chairman of the Board of Directors and Chief Executive Officer of WRG (6a).

The Complaint charges violations of Sections 10(b), 14(e), Rule 10b-5, and common law principles. In substance, it is claimed in the Complaint that since September 4, 1974, the defendants have been carrying out a plan and scheme, devised

prior to that date, through fraudulent, deceptive, and manipulative devices, to eliminate the public as common stockholders of WRG and to make WRG a private preserve for the defendant directors, for the benefit of the individual defendants; and in pursuance thereof, for no legitimate corporate purpose, to force the public common stockholders of WRG to sell their shares either by tender to WRG under an Exchange Offer designed to give them less than the true value of their stock, or, as to any public common stockholders who do not tender their shares under the Exchange Offer, by forced sale at artificially low prices after expiration of the Exchange Offer and the delisting of the common stock from the New York Stock Exchange and the cessation of a viable public market for the common stock. (10-11a).

It is claimed that the defendants have the following objectives and purposes in carrying out the plan and scheme: to forceably deprive the public common stockholders from continuing their interests as stockholders and majority owners of WRG, and from participating in the continuing growth of WRG which has annually reported progressive increases in revenues and earnings; to effect 100%, or at least initially 66-2/3%,ownership of WRG by defendant Lawrence and the other directors of WRG, who then owned 13.9% of the outstanding common; to increase the earnings per share and net assets per share attributable to the stock owned by the directors, at the expense of the public stockholders; to make defendant Lawrence the majority owner by increasing her percentage of ownership from 7% to at least 50.6%; to cause the delisting of the WRG common from the New York Stock Exchange; to

eliminate a viable market for the WRG common stock; to eliminate and deprive the public stockholders of the protection afforded to them by the Exchange Act and the S.E.C. Rules and Regulations with respect to disclosure through proxy material and the filing and dissemination of reports; to increase substantially the remuneration and other emoluments for the insiders; and, with present intent, to force the retirement of any balance of WRG common held by public stockholders who may not have tendered under the Exchange Offer. (12-14a).

It is asserted in the Complaint that pursuant to the plan and scheme, the defendants publicly announced the Exchange Offer after the market close on September 4, 1974, under which WRG would accept up to 1,405,008 shares of its common stock (all outstanding except those owned by the directors), on the basis of $3. cash and $8. principal amount of a new WRG 10-year 10% subordinated debenture for each common share tendered. The Exchange Offer became effective on November 4, 1974, and tenders were thereafter solicited through a Prospectus (58-119a) and other solicitation material. It is charged that in connection with the Exchange Offer and the request and invitation for tenders, and the solicitation of the public stockholders in favor of the Exchange Offer, the defendants made material misrepresentations and omitted material facts. The material misrepresentations and omissions are particularized in the Complaint. [Additional material misrepresentations and omissions came to light from documents produced by the defendants and testimony elicited from witnesses at the preliminary injunction hearing.] It is also charged that in connection with the Exchange Offer and the request and solici-

tation of tenders, the defendants have engaged in fraudulent, deceptive and manipulative acts and practices. The Exchange Offer is attacked as deceptively unfair to the public stockholders of WRG, as particularized in the Complaint. (14-23a).

Declaratory relief, prohibitory (both preliminary and permanent) and mandatory injunctive relief, and damages are included among the relief sought in the Complaint, as well as such other and further relief as may be just and proper in the premises. (25a).

B. COURSE OF PROCEEDINGS AND DISPOSITION IN THE COURT BELOW

This action was instituted on Tuesday, November 19, 1974, upon the filing of the Complaint (2a, 722a). Service of process was expeditedly effected on that day upon those defendants who are the appellees on this appeal (2a). In the afternoon of Wednesday, November 20, 1974, the proposed Order to Show Cause, motion and supporting affidavits and exhibits (26a-336a) were delivered to the attorneys for the appearing defendants. On Thursday, November 21, 1974, in the presence of the respective attorneys for the parties, Judge Carter signed the Order to Show Cause, bringing on for hearing on Monday, November 25, 1974, at 9:30 A.M., plaintiff's motion for a temporary restraining order and preliminary injunction to enjoin consummation of the Exchange Offer (26-29a, 722a). In the afternoon of November 21, 1974, plaintiff's memorandum of law was served on defendants' counsel. On Friday, November 22, 1974, plaintiff

served a Notice to produce documents and subpoenas. During the week-end, the defendants served their opposing papers and memorandum of law upon plaintiff's counsel. The hearing on Monday, November 25, 1974, was necessarily expedited because the Exchange Offer was then scheduled to expire at 5 P.M. on that day. [As matters eventuated, the expiration date of the Exchange Offer was extended by WRG through a series of extensions.]

At the evidentiary hearing held on November 25, 1974 before Judge Carter, five witnesses testified: Nathan Belfer, Vice President of Wood, Struthers & Winthrop-- Mr. Belfer testified as valuation expert for plaintiff (399a-433a); defendant Mary Wells Lawrence, Chairman of the Board and Chief Executive Officer of WRG (434a-471a); William Brian Little, First Vice President of White, Weld & Co., Inc., Dealer Manager of the WRG Exchange Offer (474a-507a); defendant Frederick L. Jacobs, director, Executive Vice President-Administration, Secretary and Treasurer of WRG (507a-520a); and Frank G. Colnar, director and Executive Vice President-Financial Planning of WRG (520a-522a, and Pt.II 738a-742a). In addition to testimony, both sides introduced documentary evidence. At the conclusion of the hearing (542a-545a), Judge Carter granted a temporary restraining order, effective at 5 P.M. on Monday, November 25, 1974. Initially, Judge Carter signed a Memo Endorsement and Order, dated November 25, 1974 (715a); and upon the agreement of counsel as to form, Judge Carter signed a formal Temporary Restraining Order, dated November 25, 1974 (717a). The Judge signed that Order prior to 5 P.M. on that day. Thereafter, Judge Carter rendered his decision and Order, dated December 5, 1974 (735a), denying the

motion for preliminary injunction and vacating the temporary restraining order.

Plaintiff's counsel became apprised of Judge Carter's decision in the late afternoon of December 5, 1974, and on the following morning, December 6, 1974, the Notice of Appeal was filed and plaintiff moved before this Court for an expedited appeal. The motion was denied by Circuit Judge William H. Mulligan, except for leave to file typewritten briefs and fixing a joint appendix and brief filing schedule, and hearing date, pursuant to Order, dated December 12, 1974.

C. STATEMENT OF THE FACTS

1. A Prelude To The Facts
" 'Going Private': A Lesson
In Corporate Responsibility"

On November 14, 1974, S.E.C. Commissioner A. A. Sommer, Jr. made a speech entitled, "Going Private": A Lesson In Corporate Responsibility, at Notre Dame Law School (Law Advisory Council Lecture) which reverberated nationally and received prominent newspaper coverage (53-57a). The complete speech is set forth in [Current] CCH Fed.Sec.L.Rep. ¶80,010. In the strongest of terms, Commissioner Sommer condemned the "going private" devices currently being used by corporate insiders to force out the public stockholders, as being unlawful and violative of Rule 10b-5. He specifically highlighted, as one of his examples, the WRG "going private" situation.

For purposes of a background to the pertinent facts

involved here in the context of the general "going private" dilemma being foisted unconscionably and unlawfully on the public investors, certain portions of Commissioner Sommer's speech are here quoted:

> "During the sixties and early seventies innumerable companies 'went public', that is, publicly offered their securities. During the period from 1967 to 1972 over 3,000 companies filed registration statements with the Commission for the first time, indicating it was their first major public financing. * * * In others, some or all of the proceeds went to the shareholders who owned the company prior to 'going public' and who sold part of their holdings to the public. Often the initial offerings were followed by others which, like the first, sometimes brought money into the corporate coffers, in others enriched the dominant shareholders.

[WRG was one of the companies referred to by Commissioner Sommer which went public during that period and, as will be shown, all of the WRG shares publicly sold, with the exception of 50,000 shares, were secondary offerings by insiders of WRG who reaped substantial gains on their sales to the public. The insiders of WRG went back to the public a second time on a secondary offering and again reaped substantial gains.]

> "It is not this phenomenon I wish to talk about today, as intriguing as it is. I speak today of a newer and currently, at least, more disquieting fad. That is the fad of 'going private.' Daily we read of companies which are offering to buy out all, or substantially all, of their shareholdings, thus enhancing the control of the controlling shareholders and freeing the corporation of the 'burdens' of being publicly-held. In other instances clever and indeed most imaginative devices are used to afford the small shareholders little, if any, choice in the matter. What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to American corporate mores and the securities markets than he already is.

* * *

"What is happening now is this: as market prices of stock have plummeted, often to levels below book value, many companies have commenced the process of going private. * * *.

"The means by which companies 'go private' are varied. I will discuss only a few of them: the tender offer, the squeeze out merger and the reverse split.

"The simplest way is an offer to pay the shareholders who accept a stipulated price, usually something in excess of the market price. * * * First, if significant numbers of shareholders respond to the tender, the shareholder who considers staying aboard faces significant losses. If the number of shareholdersdrops under 300 he will lose the network of federal protections built over a period of forty years for his benefit; no assurance of comprehensive disclosure, only limited protections against insider chicanery and so on. If he chooses to stay aboard he may find the liquidity of his investment -- the ability to sell readily at a price reasonably proximate to the last sale -- reduced, perhaps completely destroyed..Further, if management buys or otherwise acquires or has the power to bring it about, it may 'merge out' the remaining minority and compel them in effect to sell their investments. * * *.

"Faced with the prospect of a force-out merger, or a market reduced to glacial activity and the liquidity of the Mojave Desert, and deprived of most of the benefits of the federal securities laws, how real is the choice of the shareholder confronting the offer of management to acquire his shares, usually not with their own resources, but with the corporation's resources that really belong to him and his fellow shareholders? In short, he usually decides he damn well better take the money and run.

"The harsh dilemma posed is not confined by any means to the small unsophisticated investor. I recently spoke with an officer of a very large foundation concerning this. He complained of the dilemma in which fiduciaries are placed by such conduct. The fiduciary, if he thinks his investment has value beyond the amount of the offer and would like to hold it confronts the danger that he will be squeezed out for less or end up with a security having no market for holdings of the size he has."

In the case at bar, the WRG management did not even offer the WRG public stockholder under the Exchange Offer the corporation's resources "that really belong to him and his fellow shareholders." Here, except for the $3. cash, the WRG public stockholder who has tendered has been forced to leave his aliquot share of the corporation's resources with WRG and to lend to WRG the balance of the purchase price for his own shares via the subordinated debenture which is selling at a substantial discount. Compounding the situation, the package value is less than his total aliquot share of the corporation's resources, and the difference represents an increase in management's share of WRG's net assets. Without any cost to management, management gains with every share tendered under the WRG Exchange Offer. The gain to management is paid for by the public stockholder, by slicing off part of his aliquot share which inures to management. Commissioner Sommer included this aspect in his discussion of the WRG Exchange Offer:

> "In one recent instance (WRG) public offerings netted $696,000 for the corporation, over $12,500,000 for the offering shareholders. The corporation has now proposed to acquire all the stock held by minority shareholders for $11.00 per share. If all of the minority shareholders tender, they would receive $3.00 in cash and $8.00 in ten year subordinated debentures (which the company believes will sell at a substantial discount) for shares which were originally offered at $17.50 a share and three years ago at $21.75 a share; the dominant shareholder (Lawrence) would go from a 7% interest to 43%, with over 3.7 million dollars (less taxes) provided by the public now safely locked up for her benefit. On a pro forma basis, had all public shares been repurchased on the basis proposed at the beginning of 1973, the corporate profits attributable to her interest would have risen from $236,000 to $1,107,000 in 1973 -- over 400% -- and from $167,000 to $688,000 for the first ten months of 1974 -- again over 400% -- and without a single dime of additional investment by her!"

"I would suggest there is something wrong with that. I would further suggest that under well established legal principles such conduct may also be unlawful. It is well established in the law that officers and directors of corporations, as well as those shareholders who control it, owe fiduciary duties to the other shareholders of the corporation.

* * *

"With these general principles as guides, it is hard to see how the sort of conduct I have described can possibly meet the standard. These tender offers and these squeeze - outs usually benefit the insiders enormously; they in effect buy assets at less than book, increase their leverage, and remove the dangers of judicial and Commission scrutiny of their conduct. How can this be squared with their responsibility to the minority shareholders? Is there not a clear conflict of interest when the shareholders are offered the empty choice of tendering or being forced out one way or another while the controlling shareholders reap benefits? I believe that federal courts will increasingly be inclined to find in Rule 10b-5 the basis for concluding that the conduct which is at the heart of 'going private' violates federal securities laws.

* * *

"The shareholder must no longer be a second class citizen. Once he is invited to feast and he pays his admission, those who own the tent must not be able to usher him out at the end of the second course with only the menu as his souvenir. While the argument about the broader meanings of corporate responsibility continues, in this one area the responsibility is clear. The ethical implications are clear; so are the legal."

2. WRG - Prior To "Going Public"

WRG, a full-service advertising agency, was organized as a New York Corporation. It commenced business in April 1966. It maintains its principal offices in New York City. (220a, 722a). At the time of WRG's organization, defendant Lawrence and two co-founders (no longer with the company) made cash contributions to WRG in consideration for WRG common stock. Defendant Lawrence

contributed $30,100 (or 10¢ per share) for 301,000 shares of WRG common (adjusted for stock-splits). (233a). Defendant Lawrence did not thereafter purchase any additional shares of WRG (except for 100 shares on May 11,1970, the first day of trading in the common stock on the American Stock Exchange) until 1974, that is, after "the idea of buying back the public stock was planted in the winter of 1973" (725a, 438-442a). Of course, as will be set forth, infra, she sold a substantial number of WRG shares on the two public offerings and in the open market through the facilities of the Exchanges, reaping millions of dollars of gain. (235a, 264a, 289a-291a, 439a-441a).

During the period between the organization of WRG and June 1968, the officers and directors (including the founders) of WRG acquired a total of 1,450,600 shares of WRG common at an aggregate cost to them of $548,680, or an average cost of 38¢ per share. (723a, 220a, 43a).

By the time of the first public offering, WRG had grown to the point of being the 38th largest advertising agency in the United States (220a). Defendant Lawrence has been Chairman of the Board of Directors and Chief Executive Officer of WRG at all times since the organization of WRG (204a). She was also President of WRG until October 1971 (163a).

3. 1968 Public Offering; 1970 Listing On The American Stock Exchange

The Prospectus, dated October 31, 1968, through which the first public offering was made of WRG common stock, is set

forth at 217a-246a. A total of 409,900 shares were publicly offered, of which only 50,000 were offered by WRG itself. The balance of 359,900 shares were offered on a secondary by the Selling Stockholders who were directors, officers and key employees of WRG -- their names and respective number of shares sold are set forth at 235a. Defendant Lawrence sold 75,250 shares, and retained a balance of 225,750 shares (235a). The offering price was $17.50, and proceeds to WRG and the Selling Stockholders were $16.30 per share(after underwriting discount of $1.20). The Selling Stockholders realized a total of $5,866,370, of which defendant Lawrence received $1,226,575. The Selling Stockholders sold 25% of their holdings, respectively. On the other hand, the public investors paid a total of $7,173,250 for the 409,900 shares. (218a, 235a, 723a, 43a). That the public investors then evinced confidence in the future growth of WRG, and their willingness to invest in its future is demonstrated by the following:

> "The book value of the shares of Common Stock outstanding on September 30, 1968 was $1.73 per share. This book value will be increased to approximately $2.18 per share if adjusted for the sale of the shares offered hereby, <u>resulting in an immediate dilution to the public investors of approximately $15.32 per share</u>." (Emphasis supplied) (220a).

It is significant in relation to the material omissions from the 1974 Prospectus used in the Exchange Offer, that in the 1968 Prospectus there are set forth in detail the particulars of the original contributions (10¢ per share) by defendant Lawrence and the other founders, and the consideration paid by the directors and officers for the 1,450,600 shares, aggregating

$548,680, or average cost of 38¢ per share (233a, 220a). Full particulars are again set forth in the Prospectus, dated April 19, 1971 (247a, at 263a) used in the 1971 public offering. The 1974 Prospectus omits all references to the consideration paid by defendant Lawrence for her shares initially acquired by her, or by any of the other directors of WRG who had "agreed" not to tender under the Exchange Offer, or to the sales by defendant Lawrence of WRG common through the facilities of the Exchanges, and her gain realized therefrom (and similarly as to other directors who were not tendering), or to the number of shares initially acquired by defendant Lawrence at 10¢ per share (and similarly as to other directors who were not tendering), or to the 1974 purchases of WRG common made by defendant Lawrence and other directors and officers of WRG.

During the period between October 31, 1968 and May 8, 1970, the WRG common stock traded in the Over-the-Counter market. At the time of the completion of the 1968 public offering, there were 1,500,600 common shares outstanding, of which 409,900 were publicly sold under the offering (223a). The WRG common stock was then listed on the American Stock Exchange and trading in that stock on the Exchange commenced on May 11, 1970 (253a). It is significant that after May 11, 1970, and during the balance of the second quarter 1970 and third quarter 1970, the market price of WRG common declined to a low of 5 on August 14, 1970, and then rose to a high of 11-1/2 on September 30, 1970 (See ISL Index, at 308-309a, setting forth the daily trades, volume and prices). In the fourth quarter 1970, the price rose to

17-3/8 during December 29-31, 1970 and closed for the 1970 year at 17. (310a, 253a). In the 1971 Prospectus (248a), the following 1970 price ranges are included in the table at 253a:

Period	High	Low
* * *		
1970:		
First Quarter	15	11-3/4
April 1 to May 8	11-3/4	7
May 11 to June 30	8-1/4	5-1/2
Third Quarter	11-1/2	5
Fourth Quarter	17-3/8	10-5/8
1971:		
First Quarter	25-7/8	15-1/4
April 1 to April 19	23-7/8	21

But, a comparison of the table of price ranges in the 1971 Prospectus with the table of price ranges in the 1974 Prospectus shows a considerably distorted picture in the 1974 Prospectus table which is set forth at 76a. The 1974 Prospectus table commences with the 1971 price ranges. A WRG public stockholder viewing the 1974 Prospectus table would immediately form the impression that there was a market price downtrend from the 1972 first quarter, and that there had not historically been any marked up-trend of a substantial nature, which, of course, is not the fact. By the omission of the 1970 price ranges, the public stockholder did not have any opportunity of judging past market price performance of the WRG stock, in relation to the 1974 Exchange Offer, with a fully disclosed market picture before him. He would also be led to believe thereby that the market price of 5-1/2 immediately prior to the announcement of the Exchange Offer after the market close on September 4, 1974, was the historical low for WRG common, which was not the case. The materially misleading nature of the 1974 Prospectus table is compounded

when considered in the light of the statements contained in the 1974 Prospectus relating to the "Background and Purpose" of the Exchange Offer, set forth at 71a-72a. There, among other matters, the defendants discuss market trends, but relate back as their starting point to the market high in the first quarter of 1972, and they present a highly distorted market history picture.

4. 1971 Public Offering; 1971 Listing On The New York Stock Exchange

The Prospectus, dated April 19, 1971, through which the second public offering was made of WRG common stock, is set forth at 247a-278a. A total of 333,739 shares were publicly offered, none of which was offered by WRG itself. In fact, the only WRG shares ever publicly offered by WRG were the 50,000 shares offered in the first public offering. The 1971 second public offering was solely a secondary offering. The Selling Stockholders were directors, officers and key employees of WRG -- their names and respective number of shares sold are set forth at 264a-265a. Defendant Lawrence sold 110,850 in that offering, and retained a balance of 100,000 shares (264a). However, at the completion of the first public offering, defendant Lawrence held a balance of 225,750 shares (235a). Immediately prior to the second public offering she owned 210,850. The difference represents her sale of 15,000 shares in the open market on the American Stock Exchange, 10,000 shares of which were sold by her on November 4,1970 at 13-3/8; and her purchase of 100 shares on the first day of trading on the American Stock Exchange on May 11, 1970.(440a-441a). The offering price on the 1971 public

offering was $21.75. The proceeds received by the Selling Stockholders (after underwriting discount of $1.25) were $20.50, or a total aggregate amount of $6,841,649.50, of which defendant Lawrence received $2,272,425. (248a, 724a, 44a). The public investors paid a total of$7,258,823.25 for the 333,739 shares (248a).

On the first page of the 1971 Prospectus, the following paragraph is set forth:

> "Upon completion of the sale of the shares offered hereby, and subject to satisfaction of certain requirements of the New York Stock Exchange, the Company intends to apply for the listing of its Common Stock on the New York Stock Exchange."

That representation carries with it major legal implications in the context of the instant litigation, and the instant motion for injunctive relief. In the landmark case of United Funds, Inc. v. Carter Products, Inc., ['61-'64] CCH Fed. Sec.L. Rep.,¶91,288 (Balt.City Cir.Ct. 1963), adverted to by S.E.C. Commissioner Sommer in his "Going Private" speech, the Court enjoined the attempt by management of Carter Products to effect the delisting of the common stock, which was listed on the New York Stock Exchange, through the device of issuing non-voting common stock and paying a stock dividend of that class of stock to its voting common stockholders, as well as reserving shares of the non-voting stock for use in connection with the company's stock option plan. Under the New York Stock Exchange Rules, the issuance of a non-voting stock by a company whose voting stock is listed is one of the specific criteria leading to consideration of delisting.

In United Funds, Inc., the Court held that a state-

ment of intent to apply for listing had a meaning established by generally known usage andpractice in the financial world. It meant that application would be made, that there was good reason to believe that the application would be accepted, and that listing would be continued. This meant that the corporation would not voluntarily take any action which would result in delisting unless the action was necessary to achieve a proper corporate purpose. In this respect the Court appositely stated:

> "Under this usage and custom, such a statement of intent is meant to be and is accepted as a promise that the company making it will apply for listing, with a strong implication, which in this case was true, that there is good reason to believe the application will be accepted, upon effecting a satisfactory distribution through the public offering. The evidence convinces me that N. Y. S. E. listing is generally regarded as a material advantage for the company and its stockholders. I find also that, under this usage and custom, the statement was meant to be and was accepted as a promise that the listing would be continued.
>
> * * *
>
> "The implied promise to continue the listing, in the context, was meant to have some meaning. * * *. The meaning of the promise in this respect is clarified, in my opinion, by a consideration of the N. Y. S. E. rules, the place of those rules in security transactions and the history of delistings.

The Court then considered the importance of the Exchange Rules in the context of the framework of the Securities Exchange Act and the protection of the public investors:

> "The importance of such rules is recognized by the Securities Exchange Act of 1934, Section 12(d) of which provides that a security registered with a

national securities exchange may be withdrawn or stricken from listing in accordance with the rules of the Exchange and upon such terms as the Securities and Exchange Commission (S.E.C.) may deem necessary for the protection of investors. Section 19(b) of the Securities Exchange Act gives the S.E.C. full authority and power to approve or disapprove changes in the rules of a registered exchange. The force and importance of the N.Y.S.E. rules have been recognized by the Federal courts. Atlas Tack Corporation v. New York Stock Exchange, 246 F.2d 311 (1st Cir.); Exchange Buffet Corporation v. New York Stock Exchange, 244 F.2d 507 (2nd Cir.).

The importance attached to continued listing under the protective umbrella of the N.Y.S.E. rules and the Exchange Act was recognized by the Court in connection with the rule that, in the absence of special circumstances, the Exchange will not consider approval of delisting upon the request of the company unless a proposal for delisting is approved by 66-2/3 of the outstanding security, together with a failure of 10% of the individual holders thereof to object, as a minimum requirement. (See, Rule 500, N.Y.S.E. Rules). The Court in that context considered then the meaning of the implied promise:

> "Viewed in this context, the meaning of the implied promise to continue the listing of the Carter stock, in my opinion, becomes evident. It did not mean the listing would be continued indefinitely, apart from circumstances over which Carter had no control such as economic vicissitude. * * * It did mean, however, and was relied upon as meaning that Carter would not voluntarily take any action which, under the N.Y.S.E. rules, would result in delisting, unless that action was necessary to achieve a proper corporate purpose." (Emphasis supplied)

The Court also held that when Carter went public upon management's determination in that respect, management and the company

accepted fiduciary obligations and responsibilities owing to the public investors, and that, in addition to the breach of the implied promise involved, the defendants were also violating their fiduciary duties. In this latter respect, the Court noted that the i siders had reaped more than $5,000,000 in gains through sales of Carter stock through the facilities of the New York Stock Exchange and all personal estate planning on their part having been competed, the insiders no longer had reason for sales of Carter stock in the market. But, held the Court, the public investors did have the need for the benefits flowing from the listing and the protection afforded by the Exchange Act in requiring the dissemination of proxy material and the compulsory filing of reports with the S.E.C. and the Exchange. The Court also referred to Chapter IX (Obligations of Issuers of Publicly Held Securities) of the Report of Special Study of Securities Markets of the Securities and Exchange Commission, Part 5 (1963), in which the S.E.C. discussed the need for adequate availability and dissemination of information about issuers and the need to extend to unlisted securities the safeguards then applicable to securities listed on Exchanges under the Exchange Act. In this connection, the Court noted that, "These important protections to minority stockholders, inherent in N.Y.S.E. listing, would be lost as a consequence of delisting.*

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* Subsequent to the United Funds, Inc. decision, the Act of August 20, 1964, Sec. 3(c), effective July 1, 1964, 78 Stat. 566, et seq., added Section 12(g) to the Exchange Act, requiring registration of certain unlisted securities. In the case at bar, the WRG public stockholders face the grim certainty of not only losing the listing benefits but also the 12(g) protection. See, Reg. §240.12g-2. See also, 75a.

The Court, in <u>United Funds, Inc.</u>, also dealt with another fundamental point which is at the core of "freeze-outs" such as in the case at bar -- the so-called "<u>voluntary</u> exercise of judgment by the public stockholders." In the <u>United Funds, Inc</u>. case, the defendants contended that 72.3% of the stockholders of Carter voted for the charter amendment authorizing the non-voting common stock. The Court rejected this contention, noting that , "The stockholders were faced with a dilemma * * *. They were confronted, therefore, with the choice of voting for an action which in one respect would be prejudicial to their own interests, but in the other would be to the advantage of the corporation as a whole. There was no way in which they could separate the two aspects. <u>The position in which they were placed was unfair to them; they had no effective freedom of volition</u>." With respect to the proposed benefits claimed by the defendants to result from the authorization of non-voting common stock, i.e., proposed stock dividend; and corporate advantages of having additional stock available for acquisitions, employees' options and other purposes (the very same type of items that the defendants are contending for in the case at bar as the purported purposes for "going private"), the Court rejected defendants' arguments that such benefits offset the loss of the listing, stating:

> "The short answer to this contention is that Carter and Hoyt <u>did not have the right</u>, for the reasons which have been stated, <u>to force the minority stockholders to the choice</u>. The rights of minority stockholders cannot be taken without their consent, whatever the compensation might be thought to be, for the private purpose of the majority holders. The extension to them of the possible benefits of a stock dividend, which of

> itself, would be a proper corporate action, cannot be balanced against the wrong which will be done to them by the delisting of their stock." (Emphasis supplied).

In the case at bar, the implied promise and representation of listing contained in the 1971 Prospectus (248a) carried with it as an integral part, the promise and representation that the company and its management would not, absent special cause or the most compelling business justification, interfere with the listing of the WRG stock on the New York Stock Exchange, the protections afforded by the Exchange Act, and indeed, the rightful ownership of WRG stock by the public stockholders. It was a material and fundamental promise and representation, and the public investors had the right to rely thereon, which, obviously, WRG and the WRG management expected they would rely in making that promise and representation on the first page of the Prospectus. Not only have all purchasers of WRG stock on and after the 1971 public offering been deceived in this respect at the time of their purchases of WRG stock, but, compounding the fraud, they have been and are continuing to be faced with the "forced sale" of their stock through defendants' scheme and fraudulent course of business to "freeze out" the public investors and to "go private". This is a clear Rule 10b-5 violation, it is submitted. This particular aspect is pleaded in Par. 25 of the Complaint (23-24a). See also, Voege v. American Sumatra Tobacco Corporation, 241 F.Supp. 369 (D.Del. 1965), at page 375.

Upon the completion of the 1971 public offering, the WRG stock was listed on the New York Stock Exchange [See, Listing Application, July 15, 1971 (279a-288a) and the authorization for listing (288a) for 1,920,600 shares, of which 1,575,207 shares were issued and outstanding, 7,150 shares held in Treasury, 334,743 shares reserved for issuance under the WRG Stock Option Plan, and 3,500 shares reserved for issuance under the WRG Incentive Stock Purchase Plan.

5. WRG - Growth Company

WRG has been an aggressive, growth company continually from inception of operations. The following statistics show the growth pattern(84a, 135a-137a, 146a, 151-153a, 162a, 171a-173a):

Year Ended October 31	Gross Billings	Net Income	Per Share Net Income	
1967	$ 36,508,000	$1,217,982	1.21	
1968	53,299,000	861,017	.62	
1969	77,371,000	1,586,735	1.02	1.02*
1970	91,589,000	1,978,470	1.25	1.24*
1971	108,008,000	2,619,006	1.66	1.63*
1972	114,932,000	3,009,863	1.90	1.83*
1973	185,250,000	3,375,077	2.08	2.04*
10 mos. to Aug.31,1973	147,995,000	2,360,925	1.45	1.43*
10 mos. to Aug.31,1974	152,747,000	2,388,561	1.46	1.46*

* Net income assuming full dilution

As At October 31	Total Assets	Stockholder's Equity	Book Value Per Share
1967	$ 8,934,494	$ 1,603,107	1.10
1968	12.093,292	4,261,084	2.78
1969	15,996,734	6,399,794	4.05
1970	23,744,938	8,307,650	5.28
1971	25,277,705	10,052,820	6.37
1972	24,283,861	12,009,686	7.66
1973	36,382,714	15,467,055	9.48
As At Aug.31,1973	NA	NA	NA
As At Aug.31,1974	35,899,135	17,027,999	10.43

The defendants Lawrence and Charles Moss (President of WRG) have during the past years through the 1973 fiscal year represented to the public stockholders of WRG the solidity of their investment in WRG and the unique growth of WRG in the advertising agency field. In the 1971 Annual Report (159a-176a), defendants Lawrence and Moss included a letter, dated January 25, 1972, to the WRG stockholders (163a-164a). They advised the stockholders that notwithstanding the general economic business contraction, fiscal 1971 was a "special year" for WRG. It instituted a dividend policy; the "marketability of WRG's securities was enhanced by the agency's listing in August on the New York Stock Exchange"; and "because it is vital for WRG's clients to maintain a competitive edge in the marketplace, they remain committed to those campaigns regardless of temporary fluctua-

tions in broad economic conditions." Significantly, the following statement then followed:

> "We believe that WRG's favorable experience during the recent business contraction suggests that primary advertising agencies, like Wells, Rich, Greene, are at least recession resistant and to a great degree recession proof."

At the hearing, defendant Lawrence testified with respect to that statement (452-453) and indicated that in 1971, the economy was difficult, and a very sophisticated client who was interested in trying to acquire a greater share of the market would take advantage of a bad time to increase spending rates than to decrease spending; and those clients whose products are inexpensive will attempt to get more attention to their product in an economic slowdown; other clients had no choice but to continue to advertise. For WRG, 1971 was indeed a "special year", despite the economic slowdown. Its billings "topped the $100 million mark for the first time"; "net income rose 32.4 per cent"; and "earnings per share increased 32.8 per cent". (163a).

In the 1972 Annual Report, the defendants Lawrence and Moss once again enclosed a letter, informing the stockholders of another successful year (144a-158a). In that letter (147a), they reported that WRG "continued to outperform the advertising agency industry by virtually all of the important yardsticks"; that return on investment for fiscal 1972 was 27.3% whereas "the composite average for the publicly-held agencies is less than 20 percent.

In a letter, dated January 1974, accompanying the 1973 Annual Report (128a-143a), defendants Lawrence and Moss presented another glowing report. From the perspectives of finance, operations or service to clients, WRG "not only met the challenge, but concluded its most successful year to date" and "such an accomplishment augurs well for the future of The Company." (133a). During that year, WRG acquired Gardner Advertising Company, Inc. ("Gardner"), a St. Louis-based full service advertising agency and a "modular" operation, providing clients with a complete array of agency services either as a package or individually. (133-134a, 147a). WRG increased its dividend rate; The following significant statement was then made to the public stockholders:

> "Looking ahead, we believe that the problems faced by business and society will become tougher and more complex. We believe that these challenges <u>will present opportunities for Wells, Rich, Greene's growth and achievement unlike any we have seen.</u>"

Defendant Lawrence testified at the hearing in relation to that statement. She indicated that WRG has been always given accounts that had particularly large problems, and that "as we saw ahead, a lot of problems that we felt that we would make a major attempt to turn those problems into opportunities, as we always had in the past."(450a). It was her belief at the time that the more difficult it was for the client to maintain its competitive position in the market during economically adverse times the more the client would come to WRG for the expertise in keeping that market through advertising.(450a).

At the hearing, defendant Lawrence culminated her testimony on WRG growth with this statement:

> "A Yes, I have confidence in the continued growth of the company." (453a)

The results for the first ten months of WRG's 1974 fiscal year (ending October 31, 1974) indicate that the full year's operations culminated in higher billings and earnings than for fiscal 1973. (84a). See also 547a-554a.

6. WRG 1974 Exchange Offer - "Going Private"

(a) Events Leading To the September 4, 1974 Exchange Offer Announcement

By the end of the year 1973, defendant Lawrence owned 84,500 shares of WRG common. After the second public offering, she remained the owner of 100,000 shares. On July 17, 1972, she sold through the facilities of the New York Stock Exchange a total of 15,500 shares at 21-7/8, realizing gross receipts of $339,062.50. (440a-441a). Consequently, she sold a total of 216,600 shares under the two public offerings and in the open market, receiving approximately $4,250,000, for shares which she paid $21,660.

In January 1974, defendant Lawrence purchased 1,000 shares of WRG common (289a). In February 1974, she purchased an additional 8,000 shares (292a). In March 1974, she purchased an additional 21,500 shares (295a). The 30,500 shares purchased represented a 36% increment in her WRG stock holdings. She then held at the time of the Exchange Offer a total of 115,000 shares. If all the WRG shares sought to be acquired under the Exchange Offer were tendered or otherwise purchased by WRG, def-

endant Lawrence's percentage of ownership would increase from 7% at the time of the Exchange Offer to 50.6%. Moreover, she saw fit to purchase WRG shares at prices higher than the market value of the package offered to the public stockholders under the Exchange Offer. (332a, 289a, 292a, 295a). In addition, two other executive officers of WRG purchased WRG shares in July 1974 (298a, 301a). No disclosure of any of those purchases was made in the 1974 Prospectus under the Exchange Offer (442-445a).

According to the testimony of defendant Lawrence, the first time that WRG management discussed the matter of "going private" was last winter (454a). According to her further testimony, the top officials of WRG analyzed the "going private" situation thereafter in August, 1974; she made this significant statement in her testimony:

> "We originally had hoped to pay <u>all cash</u> for the offering, but we had checked with our banks and discovered that banks were not lending cash for the acquisition of stock and that that would be impossible. (455a).

At no point in the 1974 Prospectus is there any reference either to the first discussions last winter about going private, or the fact that WRG was intending to make an all cash tender offer. No disclosure as to how much WRG intended to borrow from the banks for such an offer; nor what management considered would be the offering cash price per share tendered. Such information would have been highly important to the public stockholder faced with the actual offer of $3. cash and $8. principal amount of a subordinated debenture that had a market value of only $8.52

(332a), as compared with book value of $10.43 per share(64a) and investment value of $20.00 per share (336a, 402a-406a).

Defendant Lawrence further testified that after the turn-down by the banks for a loan, a financial public relations advisor of WRG suggested the combination of cash and debenture as an offering package (455-456a). The WRG officials then arrived at a $3. cash and $8. debenture package, at which point defendant Lawrence called in Paul Hallingby, Jr.,President of White, Weld & Co., Inc. ("White, Weld"), the historical investment banking firm for WRG, which acted as principal underwriter for the 1968 and 1971 public offerings. Lawrence and Hallingby met on September 3, 1974. Lawrence indicated to him that the officials of WRG would "like to have had debentures perhaps funded starting after five years." Hallingby "felt they should be funded immediately." (458a). Hallingby made a few further suggestions, and he was in favor of the offer (458a). On September 4, 1974, White,Weld trasmitted a letter of that date to defendant Lawrence (565-566a). That letter is significant in numerous respects. White,Weld sought the Dealer Manager position; it was the historical banking advisor and underwriter for WRG; and it also purported to render a fairness opinion with respect to the proposed Exchange Offer -- all in one letter. Not one mention is made in the 1974 Prospectus of White,Weld's letter (over Hallingby's signature),or of the bases upon which the fairness or value of the package was arrived at; and for that matter, the public stockholders were not given one iota of opinion from management as to the fairness of the offering package, or whether the Board exercised any considered judgment as to the fairness of the package. The Prospectus is a complete void in

these respects. Moreover, at pages 71a-72a, carefully guarded language is applied in the Prospectus. Purported reasons are stated for the Exchange Offer. It is then stated that, "For these and other reasons (not expressed), the Board of Directors has concluded that it would be in the best interests of the Company to purchase its public held shares." [That statement is then followed with this withdrawal: "However, no assurance can be given that, if litigated, these reasons would be held valid."] However, the minutes of the WRG Board meeting held on September 4, 1974 (558-563a) contain no reference whatever, in the Resolution authorizing the Exchange Offer or otherwise, to any conclusion or, more appropriately, consideration that the Board considered the Exchange Offer or the purchase of the publicly held shares to be in the best interests of the company. As to fairness, the Board makes no representation one way or the other. There is a dichotomy in the language of the Prospectus between "Company" and "Board of Directors". In discussing the method of determining the value of the common stock for the Exchange Offer, it is stated that the "Exchange Offer attempts to state a value for the Common Stock only in relation to market and economic conditions prevailing prior to the announcement of the Exchange Offer" and that the "Company" believes that the method is "appropriate and proper." Consequently, the Board did not take a position that it is "appropriate and proper", and neither the Company nor the Board informed the public stockholders whether or not either thought the offer was "fair". [Once

again the withdrawal statement is resorted to; this time with respect to the method of valuing the common stock: "However, no assurance can be given that, if litigated, the method would be held valid."] Finally, it is stated, "Neither the Company nor the Board makes anyrecommendation * * *."

It is submitted that the foregoing emanating from fiduciaries who have a conflict of interest (in that the directors personally gain on each share tendered) had an absolute duty to fairly and candidly present total disclosure to the public stockholders, which they did not do.

The Prospectus states, at 59a, that, "The directors have agreed not to participate in the Exchange Offer." There is no disclosure to the public stockholders of the nature of the agreement, whether in writing or oral, and the circumstances surrounding the making of such agreement, or the reasons therefor. Defendant Lawrence testified at the hearing that the agreement was oral and was made at the Board meeting held on September 4, 1974. (447-448a).

(b) The Announcement of the Exchange Offer And Events Leading to the Effective Date

At the close of the market on September 4, 1974, WRG issued a press release announcing the proposed Exchange Offer (127a). The press release advised that the Board has approved an Exchange Offer to the common stockholders of WRG (other than the directors who have "agreed not to participate in the exchange offer"), whereby WRG will accept up to 1,405,008 shares of its common stock for cash and subordinated debentures, on an exchange basis of one

share of common stock for $3. cash and $8.principal amount of 10-year subordinated debentures bearing 10% interest rate, having a combined purchase fund and sinking fund requiring WRG to spend in cash each year over the life of the debentures 10% of the initial principal amount of the debenture issue. The offer would be made upon registration of the debentures and the taking of certain other formal steps. It was also announced that the Board had declared the regular quarterly dividend of 17 cents a share.

The market had closed at 5-1/2 on September 4, 1974. On the following day, the stock traded in the range between 7-1/8 and 7-7/8, and closed at 7-3/4, and 17,200 shares were traded on that day. (326a). During the ensuing period prior to effectiveness of registration, the arbitrageurs locked in the price range between 7-1/2 and 7-3/4, that is, below the value of the offering package, and made themselves a sizeable profit by keeping the spread open. [See, Henry, Activities of Arbitrageurs in Tender Offers, 119 U. Pa. L. Rev. 466-3 Securities L. Rev. 441; (1971)].

Unlike a cash tender offer in which the actual tender offer follows on the heels of the announcement, the exchange offer has an interim period between announcement and the effectiveness of the registration of the securities involved in the offering package. A cash tender offer "freeze-out" is deemed to involve less of a risk to the arbitrageurs in that there is not the delay period for registration.

In his letter of September 4, 1974 to Lawrence, Hallingby made the following recommendation (357a):

"We are writing to confirm our views with respect to a proposed exchange offer for all of the common shares of Wells, Rich, Greene not held by members of the board of directors. We believe that such an exchange offer could be highly successful if it were made for all shares and if no minimum response were stipulated. The latter feature is essential inasmuch as the arbitrage fraternity in the financial community typically will work especially hard to effect exchanges provided there is a firm, unconditional exchange offer to work against." (Emphasis supplied).

Consequently, here, the public stockholders of WRG were immediately faced with the dilemma so aptly described by S.E.C. Commissioner Sommer and by the Court in the United Funds case, supra. Many of them decided that they "damn well better take the money and run." Thousands of shares were sold during the ensuing period at the locked-in price range (326a), even though only a few months before the market prices were in the same range that they were selling at in the open market after the announcement, primarily to the arbitrageurs. More shares were sold on one day during this dilemma-induced selling wave than during the five weeks at which, a few months before, the market price was at the same level (324a-326a). In this type of "freeze-out" the company and the arbitrageurs are mutually supportive. The company which is freezing-out the public starts out with a cushion of tenders; that is, since the arbitrageurs will make their gain only if the offer is successful, they perforce tender and receive the exchange package. The arbitrageurs must therefore become ardent supporters of the company. In the case at bar, the arbitrageurs would initially purchase the WRG common in the open market and sell short the WRG debentures on a when-issued basis, and secure their profit provided the offer is consummated. They cover with the de-

bentures issued in the package. See, Henry, Activities of Arbitrageurs in Tender Offers, supra, 3 Securities L. Rev. p. 443. After the registration statement becomes effective, the arbitrageurs continue to profit even though the market rises to a price consonant with the value of the offering package by acting as Soliciting Dealers and receiving the fee for shares tendered through their efforts. In the case at bar, the fee to Soliciting Dealers was set at 37-1/2¢ per share with no maximum limit of the amount to be paid to any Soliciting Dealer. (68a, 123a, 125a).

In their efforts to oppose the motion for preliminary injunction, the defendants made much of the fact that they had obtained affidavits from "holders of over 600,000 shares" stating that they have read the Complaint and are opposed to the granting of injunctive relief." (339a-340a). In addition, Steven N. Hutchinson, an Associate in the Corporate Finance Department of White, Weld, moved into this aspect of the situation. He had conversations with account managers for a number of our-of-town stockholders in an effort to elicit opposition from them to the injunctive relief (340a).

Turning to those who furnished affidavits, it appears that they were supplied with copies of the Complaint. A run-down of those who furnished such affidavits shows that they are all broker/dealers (most of whom were undoubtedly arbitrageurs, who gained in one or both of two ways -- one, on the arbitrage; two, on the soliciting dealer's fee), and a list of those firms follows:

Sheriff Securities Corporation	- 59,700 shares (discretionary accounts)
Goldman, Sachs & Co.	- 31,100 shares
Oppenheimer & Co.	- 25,000 shares
Drexel Burnham & Co. Inc.	- 36,000 shares
Shields Model Roland Inc.	- 119,375 shares
Bear, Stearns & Co.	- 125,400 shares
Asiel & Co.	- 64,300 shares
Neuberger & Berman	- 128,500 shares
Edwards & Hanley	- 20,200 shares

(Their affidavits are set forth at 363a-380a; most of them appear to be form affidavits).

Turning to Mr. Hutchinson's end of this matter, apparently a summary of the Complaint was either read over the telephone or mailed to various account managers of out-of-town brokerage firms. The summary is set forth at 385a-386a. Aside from the fact that the summary is inaccurate and incomplete in various aspects, there is distressingly added a last paragraph which reads, as follows:

> "It should be noted by Stockholders that to oppose this attempt to enjoin the consummation of the Exchange Offer may be deemed a waiver of their right to join in the lawsuit as a member of the class which the plaintiff claims to represent and to share in any amounts that may be awarded to plaintiff should his suit be successful." (Emphasis supplied)

Mr. Hutchinson, according to his affidavit (382a), spoke to one, Gerald V. White, a General Partner of Trubee, Collins & Co., a securities brokerage firm located in Buffalo, New York. He spoke to Weber on the telephone on three consecutive days, and sent to Weber a copy of the foregoing summary of the Complaint.

Weber then "read" the summary to certain of his clients; and also, Weber intended to tender for certain of his discretionary accounts.

Mr. Hutchinson also telephoned one, Paul W. Strunk, in California, a securities manager. Hutchinson then read him the summary of the Complaint. Strunk informed Hutchinson that he had tendered 12,000 shares for discretionary account clients. (382a-384a).

Defendants claimed before Judge Carter that all of the foregoing were "members of the class" in the instant action and that they opposed injunctive relief, with the design of influencing the Court's judgment. But, obviously, arbitrageurs are not members of the class. The arbitrageurs bought shares from the forced sellers in the open market, and then arbitraged for their profit. The class consists of those persons who were stockholders on September 4, 1974, and who thereafter sold, tendered, or still retain their shares. They are the injured class members. The activities of the foregoing arbitrageurs and broker/dealers in supplying affidavits at the behest of WRG and White, Weld and thereby participating in litigation may indeed involve an aiding and abetting of WRG and its agent, White, Weld as Dealer Manager, in the fraudulent and deceptive offer and further place such arbitrageurs in violation of Rules 10b-6 and 10b-13 by failing to limit their activities strictly to their arbitrage and dealer functions. See, Aranow and Einhorn, Tender Offers for Corporate Control (1973 ed.) 173-191. To the extent that Hutchinson of White, Weld, the agent for WRG, solicited members of the Class to obtain waivers, a serious matter of interfering with class members without Court authorization is raised. See: Manual for Complex Litigation

1.41(4). The attempt to obtain waivers contravenes Section 29(a) of the Exchange Act.

On September 5, 1974, Catharine Gibson, a Vice President of WRG (who had sold shares on the two public offerings), purchased 1,000 shares of WRG common. That was the day immediately following the press release announcement of the Exchange Offer, and the first day of trading after the announcement. (304a). No disclosure of her purchase was made in the Prospectus, nor was it disclosed that she was one of the officers of WRG who did not intend to tender (444a, 508a). Defendant Lawrence testified with respect to defendant Gibson's purchase: "I thought that was. pretty smart of her." (444a).

(c) The Effective Date of the Exchange Offer and Subsequent Events

At the time that the Exchange Offer became effective, there was a total of 1,631,858 shares outstanding; 57,337 shares held in Treasury; and 334,223 shares reserved for exercise of stock options under the WRG Stock Option Plan (106a). At the time of completion of the first public offering in 1968, there was a total of 1,500,600 shares outstanding and none held in Treasury (223a). Consequently, a total of 188,595 additional shares had been issued by WRG between the time of completion of the 1968 public offering and the Exchange Offer, represented by 26,119 shares issued on the exercise of stock options under the WRG Stock Option Plan, 85,000 shares issued pursuant to the WRG Incentive Stock Purchase Plan, and 77,476 shares issued on the acquisition by WRG of Gardner Advertising Company, Inc. (112a, 115a, 117a).

The Exchange Offer became effictive on November 4, 1974 (59a). Its expiration date was originally November 25, 1974. There were two extensions, and the final expiration date was January 4, 1975. Defendant Lawrence made a fundamentally important statement in her testimony (469a):

> "A If the offer is not totally successful, we will provide a market for the stock that is still remaining and <u>we will determine then precisely how to go about acquiring what we finally want to acquire, which is private status.</u> We have not made that decision yet." (Emphasis supplied).

For the first time, the top executive officer of WRG has stated unequivocably that there will be a second step as part of the scheme to "go private". They just have not decided as yet what that step will be. But, that they will take another step to wipe out any remaining public ownership of WRG common is no longer in any doubt. At no point in the Prospectus is there any statement to the effect that WRG will take whatever steps may be required to obtain complete private status should not all shares be tendered under the Exchange Offer. On the contrary, there is complete non-disclosure in that respect. Of course, there are in terrorem statements of veiled threats, but the entire tenor of the Prospectus is fraudulently and misrepresentatively cast in the form that the Exchange Offer is a "voluntary" offer.

WRG has now announced the final results of the Exchange Offer. A total of 1,165,580 shares have been tendered. There remains outstanding a total of 466,278 shares, of which the public owns approximately 201,226, the directors own 226,850, and certain officers who are not directors own 38,202 shares. The insiders therefore own 265,052 shares, or 56.8% of the remaining

outstanding stock. The common stock has been suspended from trading on the New York Stock Exchange, pending application for delisting approval. A total of $9,324,640 in principal amount of the WRG subordinated debentures have been issued, and they are now trading on the American Stock Exchange.

Preliminary injunctive relief is essential, it is submitted, to enjoin WRG and its officers and directors from taking further steps to retire the remaining publicly held outstanding shares of common stock pending final determination of this action. Plaintiff will be prepared to proceed to trial expeditiously upon reasonable further discovery. Plaintiff further submits that on the basis of the record facts thus far established, the defendants have violated Sections 10(b) and 14(e) and Rule 10b-5 thereunder, as a matter of law. Hurwitz v. Directors Guild of America, Inc., 364 F.2d 67 (2nd Cir. 1966).

ARGUMENT

I

THE DEFENDANTS HAVE ENGAGED AND ARE THREATENING TO FURTHER ENGAGE IN MANIPULATIVE AND DECEPTIVE DEVICES, ACTS AND PRACTICES, AND HAVE MADE MATERIAL MISREPRESENTATIONS AND HAVE OMITTED TO STATE MATERIAL FACTS, IN CONNECTION WITH THE "FREEZE-OUT" OF THE WRG PUBLIC STOCKHOLDERS AND IN CAUSING WRG TO "GO PRIVATE", IN VIOLATION OF SECTIONS 10(b), 14(e) and RULE 10b-5.

A. The Devices, Acts and Practices Engaged and Threatened To Be Engaged In By the Defendants Contravene the National Public Interest and Congressional Policy To Protect Public Investors and To Maintain the Integrity Of the Securities Markets.

The disastrous effects that may be anticipated by

any judicial sanction of the practices of "freezing out" public investors from their stock holdings, such as being perpetrated by WRG in the case at bar, and which is being attempted by an alarming number of public corporations, may be observed from the following statistics. There has been an erosion of the small investor's confidence in the market place; the number of individual shareholders in the United States has declined by as many as 800,000 since early 1972; and trading on the New York Stock Exchange attributable to large institutional investors has increased from 35% in 1963 to 70% in 1974, and those institutional investors have been concentrating their investments in a relatively small number of select stocks. Hearings on S-2787 and S-2842 Before the Subcommittee on Financial Markets of the Senate Committee on Finance, 93d Cong. 2d Sess. 4 (1974). However, studies show that between 70 to 75 percent of the stock of publicly held companies are owned by individuals; and although they may not be buying and selling stock at the present period, they still as a result have a vital interest in business. Georgeson & Co., Trends in Management/Investor Relations, Dec. 1973, at p. 1.

Congress, the S.E.C., and the securities industry have been taking steps designed to restore the small investor's confidence in the market place. S.E.C. Chairman Ray Garrett, Jr. has stated that he was confident that the individual investor would return to the market place because he would be able to find a more "welcome and suitable environment resulting from the efforts of the securities industry and the SEC." SEC News Digest, Mar. 13, 1974, at p. 1. Congress has been acting through legislation, supra.

Significant amounts of annual capital requirements of industry and utilities have traditionally been raised from investments made by individual investors. The erosion of such investors and the strain imposed on the securities markets by the trading habits of institutions, have created a liquidity problem both monetarily and market-wise. SEC News Digest, Mar. 13, 1974, at p.1. A money strain has been placed on corporations which either cannot get the capital they require to meet their own and the nation's needs, or they can obtain such capital by borrowing at very high interest rates, by incurring burdens of debt and interest charges which are a danger to their survival.* BNA Sec.Reg.&L. Rep. No. 236, at A-15 (Jan. 23, 1974).

In the next twenty-five years, the capital requirements of public corporations will be enormous; it has been estimated that in the energy field alone the cumulative capital requirements of electric public utilities will approximate 1 trillion 200 million dollars. Jones, The Challenge of Capital Attraction, Financial Executive, Nov. 1973, at p. 31. It has also been estimated that industry generally will need equity financing at the rate of 11 billion dollars annually by 1980. Wood, Why It's Hard to Raise Capital Today, Financial Executive, Nov. 1973, 21, at p. 24. Significant amounts of these annual capital requirements have traditionally been raised from investments made by the individual investors. The restoration of confidence of the individual investor is essential.

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* WRG, a service company, historically did not require substantial borrowings. WRG long-term debt amounted to $316,750 at August 31, 1974. (106a). It faced banking difficulties only when it sought borrowing to finance a "going private"all cash tender offer (455a). WRG then "borrowed" from the public stockholders to eliminate them as stockholders, at a discount. In its efforts to go private, it now faces a funded debt of $9,324,640.

That the current wave of "freeze-outs" will have a deleterious effect upon restoration of public confidence in the market place, is indicated in the speech of SEC Commission Sommer:

> "The absence of the individual investor from the market place is deplored on all sides. * * * I do believe that to some extent the departure of the small investor from the market place has been the consequence of a deepening suspicion of the motives and the fairness of many responsible for the conduct of the corporate enterprise. Surveys have indicated time and again that small shareholders believe they are disadvantaged vis-a-vis large and institutional investors as far as information goes. I cannot imagine that the continued flourishing of schemes through which small shareholders are squeezed out against their will, or given an alternative between surrendering their ownership and engaging in prolonged and expensive litigation, does anything to promote confidence in the market."

The enforcement of Sections 10(b) and 14(e), and Rule 10b-5, it is submitted, is the appropriate process to curtail these deceptive and manipulative "freeze-outs", which are in contravention of the purposes and Congressional policy for the enactment of these anti-fraud statutes. In Crane v. Westinghouse Air Brake Co., 419 F.2d 787 (2nd Cir. 1969), cert. denied 400 U.S. 822(1970), this Court appositely stated:

> "Manipulative schemes may not be allowed to succeed solely because they are novel. A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967). The Act was designed '[t]o provide for the regulation of securities exchanges and of over the counter markets ...[and] to prevent inequitable and unfair practices on such exchanges and markets...' 48 Stat. 881; see 15 U.S.C. §78b. As this court emphasized in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 858, 860 (2d Cir. 1968), cert. denied sub nom. Coates v. SEC, 394 U.S. 976 (1969), the purpose of the Act was to 'protect the investing public,' to 'promote free and open public securities markets' and to 'secure fair dealing in the securities markets.'"

The Supreme Court, in Superintendent of Insurance v. Bankers Life & Casualty Co., supra, called for a liberal inter-

pretation of Section 10(b) and Rule 10b-5, and recognized that disregard of fiduciary responsibilities comeswithin the purview of that section:

> "The Congress made clear that 'disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web' along with manipulation, investor's ignorance, and the like. H. R. Rep. No. 1383, 73d Cong. 2d Sess. 6. Since practices 'constantly vary and where practices legitimate for some purpose may be turned to illegitimate and fraudulent means, broad discretionary powers' in the regulatory agency 'have been found practically essential.'"

The Supreme Court in the Bankers Life case also indicated that one of the purposes of Section 10(b) was to "preserve the integrity of the securities markets", adding:

> "Section 10(b) must be read flexibly, not technically and restrictively. Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under Section 10(b), whatever might be available as a remedy under state law."

As Circuit Judge Timbers stated in Chris-Craft Industries, Inc. v. Bangor Punta Corp., 480 F.2d 341 (2nd Cir. 1973), cert denied, 414 U.S. 924 (1973), "The Senate Report which accompanied proposed §14(e) indicates clearly -- more specifically that does Rule 10b-5 -- that ¶14(e) was intended to make applicable to a tender offer the long established anti-fraud proscriptions of the federal securities laws". The Court in Chris-Craft indicated the importance of enforcing the antifraud and antimanipulation provisions of the statutes, as follows:

> "[I]t may be illuminating to focus upon the reasons Congress enacted the antifraud and antimanipulation provisions of the statutes. Obviously Congress was concerned about the plight of the average public investor who is at a serious disadvantage in dealing with persons possessing super-

> ior knowledge, skill and resources. But the public in the role of investor is only part of the picture. The integrity and efficiency of the securities markets are even more important since our entire economy is dependent upon these markets."

Congress certainly did not intend, by the enactment of the anti-fraud statutes, to permit a situation to continue nationally in which a public stockholder on any given morning may read in the newspaper the substance of his company's press release, that his fiduciaries (management) have targeted him for extinction as a stockholder of the company through a "freeze-out" device. In that setting, how could any public investor confidently invest in any public corporation, except in the giant industrial or utility corporations?

B. The Defendants Have Engaged and Are Threatening To Further Engage In A "Device, Scheme, Or Artifice To Defraud" and "Acts, Practices, Or Course Of Business Operating As A Fraud and Deceit"Upon Public Stockholders Of WRG.

The device and course of business forming the fraudulent and deceptive conduct in the "freeze-out" situations is the corporate mechanics used to effect the "forced sale" of their stock by the public stockholders for the personal gain of the management or controlling stockholders. The corporate mechanics utilized (whether tender offer for all publicly held shares, or a merger "squeeze-out" or the older and more traditional method, i.e. the dissolution) may be literally in compliance with State la[illegible]nder which the corporation was organized, but such transactions will nevertheless not be permitted to go unredressed. Built into the "forced sale" is the relationship

of fiduciary and cestui que trust and of contract between the corporation, its management, and its stockholders, that there will be fair dealing. In such situations, the Courts have not hesitated to strike down the corporate device used. More recent cases have involved the application of Section 10 and Rule 10b-5. Bryan v. Brock & Blevins Co., Inc., 343 F.Supp. 1062 (N.D.Ga. 1972), aff'd 490 F.2d 56(5th Cir. 1974); Albright v. Bergendahl, supra, Civ. No. C74-134 (D.Utah, 1974) (annexed as Addendum"A" to this Brief); Levine v. Biddle Sawyer Corporation [Current] CCH Fed.Sec.L.Rep. ¶94,816 (SDNY 1974). See also, Broder v. Dane, [Current] CCH Fed.Sec.L.Rep. ¶94,875 (SDNY, 1974); University Capital Corporation v. Barbara Lynn Stores, Inc., 74 Civil 4460 (SDNY, 1974) -- oral decision of District Judge Weinfeld rendered after hearing on preliminary injunction -- a copy of Judge Weinfeld's oral decision is annexed hereto, as Addendum "B", since it is not reported.

The fundamental concept was aptly stated in Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1941):

> "The so-called dissolution was a mere device by means of which defendant appropriated for itself the transportation business of the Steamship Company to the detriment of plaintiffs. That the source of this power is found in a statute, supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny. * * * The books are full of instances of disapproval of such action."

See also, Vorenberg, "Exclusiveness of the Dissenting Stockholder's Appraisal Right," 77 Harv. L. Rev. 1189 (1964; Brudney and Chirelstein, "Fair Shares In Corporate Mergers and Takeovers," 88 Harv. L. Rev. 297 (Dec. 1974).

The use of the tender offer device is, in substance, no different from the device of racial "block busting" used in another era and which has been outlawed. It is the fraudulent device and course of business of stimulating a fear of loss thereby inducing the target to reach the conclusion that "he damn well better take the money and run."

The tender offer device involves a neatly designed market manipulation, in order to effect the "freeze-out". The device is triggered at a time when the market price is depressed and is substantially below book value and investment value. The cash offered or the securities package offered is carefully fixed in amount or value to be somewhat above the depressed market price but below book value and investment value. The target stockholders who up until that time had found no reason to dispose of their shares and were holding for investment are galvanized into action by fear that other stockholders will tender and leave him as a small minority subject to being eliminated on the next step at a substantially lower price dictated by management and in the interim with no viable or liquid market for the stock. Establishing the price somewhat above the depressed market also permits the arbitrageurs to work assiduously to bring in tenders.

A crucial part of the deception is that management, standing to personally gain substantially by the tenders of the public stockholders, does not furnish the targets with any evaluation of the fairness of the offer even though management is in a fiduciary capacity and it has a clear conflict of interest.

That such non-disclosure is itself a violation of Section 10(b) [and Section 14(e) as well) is manifest. In Bailey v. Meister Brau, Inc., [Current] CCH Fed.Sec.L.Rep., ¶94,837 (ND Ill. 1973-4), the Court referred to this duty of disclosure:

> "Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968)(en banc), cert denied, 395 U.S. 906 (1969); Penn Mart Realty Co. v. Becker, 300 F.Supp. 731 (S.D.N.Y. 1969); and Continental Bank & Trust Co. v. Garfinkle, 292 F.Supp. 709 (S.D.N.Y. 1968), * * * teach that if the controlling shareholder or directors of a corporation cause the corporation to participate in a securities transaction in which they have a conflict of interest without disclosing to the other shareholders information in their possession which reflects upon the fairness of the transaction, their acts constitute a violation of Rule 10b-5."

As fiduciaries, management was required to furnish the public stockholders with an evaluation of the package and an opinion as to the fairness of the package in the light of the operations and business of the company; and such an opinion should have been supplied by an independent source since management is in a position of conflict of interest. A fundamental purpose of the Exchange Act was "to substitute a philosophy of full disclosure for the philosophy of caveat emptor." S.E.C. v. Capital Gains Research Bureau, Inc., supra 375 U.S.,p. 186; Herpich v. Wallace, supra, 430 F.2d 792 (5th Cir. 1970); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). See also, Affiliated Ute Citizens v. United States, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972). And, a fiduciary may not resort to caveat emptor when acquiring trust assets from the cestuis que trust. Pepper v. Litton, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed 281 (1939) -- "He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. * * * [T]he burden is on the dir-

ector or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested there * * * ."

As indicated in the Statement of the Facts, supra, not only were the WRG stockholders not supplied with any independent evaluation of the fairness of the package, but the deceptive opposite was used -- namely, not even an opinion by management itself that the package was fair. The stockholders were left with caveat emptor, to the extreme. This should be compared with the efforts of management to inform their stockholders of the fairness or unfairness of tender offer made by a competitor to obtain control of the target company. In such instances, management does not hesitate to communicate with the stockholders and express its opinion as to fairness of such offer. Gulf & Western Industries, Inc. v. The Great Atlantic & Pacific Tea Co., 476 F.2d 687 (2nd Cir. 1973); Butler Aviation International, Inc. v. Comprehensive Designers, Inc. , 425 F2d 842 (2nd Cir. 1970). Management considers that it is its duty to so inform the stockholders under such circumstances. Assuredly the law does not permit management, as fiduciary, to avoid advising the stockholders of the fairness of an offer made by the corporation for its own shares, where management stands to gain from every share tendered by the public stockholders.

The manipulation of the market price in connection with the Exchange Offer has been discussed above in the Statement of the Facts. WRG was informed by White,Weld that the debentures would sell at a 25% discount (568a). Consequently, the defendants knew that the package would not have a market value of more than $9.

Actually, the debentures have been trading at a 31% discount, resulting a a package value of $8.52 (332a). The book value of WRG stock was $10.43 on August 31, 1974 (333a). Nathan Belfer, the evaluation expert for plaintiff, evaluated WRG stock using the three principal valuation methods [among other considerations stated by him in both his affidavit (331a-336a) and in his testimony (399a-433a)]. The three valuation methods are market value, book value, and investment (or historical intrinsic] value. Belfer considered that the current market was aberrationally depressed and that the WRG stock was then currently selling an an unrealistically and irrationally low price for a company with excellent earnings record and with a fine quality management and reputation(405-406a). As to book value, Belfer compared book value of WRG, as a service company, with book value of manufacturing companies. He considered that WRG as a service company, without factories, machinery, and very expensive equipment, but with book value consisting mainly of accounts receivable, cash, and similar assets, had a "very clean book value." (407a). Belfer considered that investment (historical intrinsic) value was the appropriate method to be applied. He considered the earnings and market prices for five years, and applied the average of the average price-earnings ratios for the five years (10.7 multiplier) to 1974 earnings estimated at least $2.04, and arrived at an intrinsic value of approximately $22. The five-year period used by Mr. Belfer in arriving at such intrinsic value covered the years 1969 thru 1973. He then eliminated the year 1969 and included estimated 1974 in arriving at the average of the past five years' earnings,

and substituted such five-year average earnings of $1.78 for the current earnings level of $2.04, and reached an intrinsic value on that basis, upon applying the multiplier, of $19. He concluded that true, intrinsic, going concern value for WRG stock was approximately $20. per share (333a-336a). His final opinion with respect to the fairness of the package is, as follows:

> "On all the factors considered in my analysis it is my opinion that the offer by WRG to its stockholders of cash and securities, having together a current value of $8.52, approximately 18% below the current book value of $10.43 per share is grossly inadequate. It is substantially below a true, intrinsic, going concern value of approximately $20.00 per share."

On the other hand White, Weld, which cannot be deemed an independent expert in this matter by reason of the close historical relationship of that firm with WRG and its position as Dealer Manager in the Exchange Offer (receiving a fee on every share tendered as a foundation of compensation), purported to value the package on primarily two bases. Firstly, the price paid by a company for another company's shares and the premium over market prices which such price reflects (356a). On cross-examination, Mr. Little indicated that in making such an evaluation on that basis, he did not distinguish between another company making an offer for the target company's stock, and the company making an offer for its own stock (493a). This approach fails to take into consideration that a company acuiring its own shares is actually in a pro tanto liquidation, whereas such a situation does not exist where another company makes an offer for the target company's stock. Also, a strong fidu-

ciary obligation is involved when a company seeks to acquire all of its own stock, except the shares owned by the directors. A company seeking to acquire shares of a target company on a tender offer ordinarily will not have any fiduciary obligation (unless it already is a controlling stockholder and dominates the target company as a subsidiary) and may set any price it may consider beneficial to its own interests. The second basis used by Mr. Little, and one he considered paramount, was applying the "work-out" of the debenture, that is, if the stockholder should hold the debenture for ten years, he would get $11. total. (484a-485a). The untenability of this approach is manifest. Little conceded that his firm discounted the debenture by 25%; he further conceded that it would be the company's route to acquire the debentures in the open market at the discount price in order to satisfy the sinking fund requirement (485a-491a). Moreover, to evaluate the package at full par for a ten-year work-out is contrary to proper valuation technique.

The authorities are overwhelmingly supportive of the approach taken by Mr. Belfer. See, Valuation of Dissenters' Stock Under Appraisal Statutes, 79 Harv. L. Rev. 1453 (1966). Most courts have required that valuation be primarily based on investment (intrinsic) value, preferring to average (as Mr. Belfer did) over a five-year period. Sporborg v. City Specialty Stores, Inc., 35 Del.Ch. 560, 123 A.2d 121 (Ch. 1956); Application of Delaware Racing Assoc., 213 A.2d 203 (Del. 1965); Woodward v. Quigley, 133 N.W.2d 38, modified on rehearing, 136 N.W.2d 280 (Iowa 1965). All factors are to be taken into consideration, and market is not deemed controlling. Willcox v. Stern, 18 N.Y.2d 195, 273 N.Y.S.2d 38(1966); In re Kaufmann, Alsberg& Co., 220 N.Y.S.2d

151 (S.Ct.NYCo. 1961), aff'd 15 A.D.2d 468, 222 N.Y.S.2d 305 (1st Dept. 1961). The Court below cited Application of Deutschmann, 281 App.Div. 14, 116 N.Y.S.2d 578 (1st 1952) as the basis for indicating fair value, in reference to the use of current market value by the defendants. However, the authorities recognize that Deutschman does not represent New York law, and it was a "special fact" situation involving A.T.& T., the largest daily volume stock traded on the New York Stock Exchange at the time. 79 Harv. L. Rev., supra, pp. 1462-1463. The Federal Courts have indicated that the appropriate method of valuation is principally investment value. Chris-Craft Industries, Inc. v. Piper Aircraft Corp. [Current] CCH Fed.Sec.L.Rep..¶94,856 (SDNY 1974); Morris v. Burchard, 373 F.Supp. 373 (SDNY 1974); Vandervale v. Put and Call Brokers, 344 F.Supp. 118, 150-151 (SDNY 1972).

The "freeze-out" involved in the case at bar involves, therefore, a market manipulation casting the price at a manipulated price somewhat above a known depressed market, opportunistically triggered by fiduciary-directors at a time at which they can personally reap gains by reason of the facts that they will not tender; that they have sliced for themselves an increased book value-per share, and an increased net earnings per share amounting to millions of dollars; that they have entrenched themselves in control; and that they have the leverage to reap all of the future gains in book value and net earnings to be realized from a growth corporation, such as WRG. Moreover, the device causes "forced sales" to the point at which they can move on to the second of the series of steps involved in the freeze-out, and eliminate the balance of the public shareholders. As

integral parts of this fraudulent device and course of business, they intend thereby from the inception of the implementation of the device and course of business to effect the delisting of the stock, the termination of federal regulation of the company with respect to disclosure requirements, and the cessation of a viable or liquid market in the stock. Also, additional integral parts of the fraudulent device and course of business are non-disclosure as to the fairness of the offer; and actual unfairness of the offer. This conduct is clearly within the parameters of Section 10(b) and Rule 10b-5. Schlick v. Penn-Dixie Cement Corp., supra.

The Court made certain findings that clearly are grounds for holding a violation of Rule 10b-5, and in not so holding it erred as a matter of law. In this respect, Judge Carter stated:

> "Obviously, defendants are seeking to capitalize on the current economic downtrend and are offering their shareholders a package which is attractive only because of unfavorable economic conditions. In fact, the package is saleable only because of those conditions." (733a)
>
> "The shareholder may tender his stock and sell the debentures at a discount in order to get out while he can." (733a)
>
> "He may, however, gamble and refuse to tender" (733a)
>
> "[He may] tender and indicate his faith in WRG's future properity by holding the debentures until maturity." (733a)
>
> "Nor has the federal securities law placed profit-making or shrewd business tactics designed to benefit insiders, without more, beyond the pale." (734a)

The Court has thereby found that the defendants have taken advantage of an aberrational market condition, as a shrewd business tactic designed to enrich the insiders, to force the public stockholders (cestuis que trust) to tender or take the risky circumstances of not tendering, and if they do tender they have the choice of getting out while they can.

Judge Carter completely disregarded Rule 10b-5(a) and Rule 10b-5(c). He misinterpreted Popkin v. Bishop, 464 F.2d, p. 721. Judge Carter considered that if there were full disclosure, then there could be no violation of Rule 10b-5. But that is not what the Popkin case stands for. Popkin holds that if there is no deception or manipulative device [and a concession that there is full disclosure], unfairness *per se* does not come within the purview of Rule 10b-5. That is not at all the situation in the case at bar. That distinction is made clear in the Schlick case.

Not only are Judge Carter's findings a predicate for violations of Rule 10b-5(a),(c), but also on pendent jurisdictional grounds there can be no gainsaying that on such findings a blatant breach of fiduciary duty was involved. Bryan v. Brock & Blevins Co., Inc., supra; Lebold v. Inland Steel Co., supra; Theis v. Spokane Falls Gas Light Co., 34 Wash. 23, 74 Pac. 1004 (1904); Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919); Eisenberg v. Central Zone Property Corp., 306 N.Y. 58, 115 N.E.2d 652 (1953).

If Judge Carter were correct, those in control would have an absolute freeze-out right and would decide, rather than the stockholder, when the stockholder shall sell his stock; and the stockholder involuntarily must decide on risks and gambles

not of his own making. That is not the law, it is submitted.

The defendants contend that there are legitimate corporate purposes for the Exchange Offer. On the authorities, these purported purposes have no substance and are not in any sense legitimate. The so-called purposes set forth in the Prospectus (71-72a), may be summarized as follows: (72a)

1. Disappointment in the decline in the market prices of the common stock of WRG [Although the defendants concede that,"The Company cannot predict the future market value of its common stock."];

2. Because of the decline in the market prices, stock options have not provided the incentives for employees;

3. Stock at current prices do not serve as effective means of acquiring other agencies;

4. Company does not need public market to raise capital;

5. As private agency, Company would have reduced concern for immediate impact of costs upon earnings and of earnings upon the value of the stock;

6. As private agency, Company could increase salaries and grant other remuneration, including stock options based on book value;

7. Elimination of reporting requirements under the Exchange Act and all public disclosure (called confidentiality) would benefit Company in its relations with employees, clients, and negotiations for acquisitions.

It is apparent that purpose (1) has no legal basis. There is no corporation in the land which is anything but disappointed in the current market prices of its stock. The same holds true as to purpose (2); and moreover, defendant Jacobs conceded in his testimony that by reason of low market prices generally, stock options are not presently in favor as incentive compensation in any public corporation (508a). With respect to purpose (3), depressed market prices of securities of public corporations generally do not serve as effective means of acquiring other companies - that situation certainly is not unique to WRG. As to purpose (4), it comes with ill-grace for the defendants to state as a purpose that the Company does not need a public market to raise capital, in the light of the fact that it never did need a public market for such purpose, but the public market was created so that through public offerings on secondaries by the defendants and other officers, and through sales in the open market at high market prices, these defendants were able to reap millions of dollars for themselves, and now that their millions are safely tucked away, they are prepared to go private once again. That is certainly not a legitimate corporate purpose. As to purposes 5 and 6, the defendants are stating, in effect, that they can bestow millions of dollars of increased salaries and incentive compensation on themselves and other officers and key employees, without accounting to the public stockholders. The personal aggrandizement in that respect may be compared with the liberalness with which the public stockholders have agreed to every form of incentive compensation and other benefits for employees that were ever brought before the stockholder body for approval.

A review of the liberal benefits that have flowed to the officers and key employees is set forth at 192a-216a, 96a-104a, 327a, 579a-679a. There have also been substan[illegible]creases each year in salaries, wages, and employee benef[illegible]).

With respect to stock options based on book value, the defendants have stated that book value more truly reflects the worth of WRG than the public market (465a, et seq.). But defendants did not even see fit to offer the public stockholders a package having a current value equal to the book value. Moreover, WRG did have a plan (Stock Purchase Incentive Plan) under which the employees were granted rights to purchase stock at the greater of 40% of consolidated net earnings or book value. Moreover, there is no impediment to promulgating a plan for options or rights geared to book value (510a); and if the Company considered that there would be a question in relations with stockholders in that respect, the Company could have presented such plan to the stockholders at an Annual Meeting for authorization, which WRG did not see fit to do, except at the time of the Stock Purchase Incentive Plan which was approved by the stockholders.

The purpose of "confidentiality" -(7)- is a sham, in that, as brought out in testimony, while WRG will be able to deregister and not be required to filed reports and disseminate important information via press releases, etc., or to obtain proxies, upon reducing the number of public stockholders below the300 number, nevertheless by reason of the registration of the new WRG debentures, it will be at least 5 years b efore reporting requirements would terminate with respect to the deb-

entures. It will take WRG that length of time on the defendants' present estimates to acquire sufficient debentures at a discount in the public market to reduce the outstanding principal amount of such debentures, and the number of debenture holders below the requisite number. (459a-464a, 97a-104a). To opportunistically proceed at the present low market prices to eliminate the public stockholders as such, for a purported "purpose" that is some five years away appears to be nothing but a purpose made out of whole-cloth.

In substance, defendants are stating that WRG is no longer a viable vehicle for publicly held stock. This type of pseudo-purpose was summarily rejected by Chief Judge Ritter in Albright v. Bergendahl, supra. The contention that a proper purpose is involved in relation to options for employees was rejected in the United Funds case, supra. And, a purpose to limit stock ownership to directors, officers, and employees was rejected in Bryan v. Brock & Blevins Co., Inc., supra.

C. The Defendants Have Made Material Misrepresentations and Have Omitted to State Material Facts In Connection With The "Freeze-Out" and "Going Private", Including the Exchange Offer and The Requests Or Invitations For Tenders Of WRG Common Stock.

The Court below considered only five of the numerous claimed misrepresentations and omissions of a material nature. The Court below also misapplied the standard of materiality, and in that sense it misinterpreted the law in reaching ultimate findings of fact.

Since this action involves Sections 10(b) and 14(e),

and not Section 14(a), it is submitted that the appropriate standard of materiality should be "whether a reasonable investor <u>might</u> have considered the misrepresentation or omission to be important in deciding whether to accept the tender offer". <u>Sonesta International Hotels Corp. v. Wellington Associates, supra</u>; <u>Affiliate Ute Citizens v. United States</u>, <u>supra</u>.

The material misrepresentations and material omissions claimed herein are, as follows:

1. The defendants deceptively represented in the Prospectus that the Exchange Offer was "voluntary", when in truth and in fact the entire Prospectus is cast in subtle language of duress, and inferences of deprivation or possible deprivation of rights (listing, market, disclosure) if the investor did not sell his stock; (59a)

2. The defendants failed to disclose that the purpose and intent of the Exchange Offer was to place control of WRG in the directors, and particularly defendant Lawrence, and to increase their interests in the assets and earnings of WRG. <u>Graphic Science, Inc. v. International Mogul Mines, Ltd.</u>, [Current] CCH Fed.Sec.L.Rep. ¶94,834 (D.DC 1974)

3. The defendants failed to disclose whether or not the directors considered the Exchange Offer fair to the public stockholders of WRG. This is especially material when there is no contest between a target company and a competitor. "If there is no contest between companies, and target management supports the tender offer, a lower standard of materiality is appropriate, as for other one-sided communications," 1A Bromberg, <u>Securities Laws: Fraud</u>, § 6.3 (1969); <u>Missouri Portland Cement Co.v. Cargill</u>

Inc., 498 F.2d 851, 873 (2nd Cir. 1974) (no opposing side - "there is no justification for anything but the most straightforward and fullest disclosure.").

4. The defendants failed to furnish an independent expert opinion on the matter of fairness of the package under the Exchange Offer in relation to the fair value of the common stock. University Capital Corporation v. Barbara Lynn Stores, Inc., supra; Denison Mines Ltd. v. Fibreboard Co., [Current] CCH Fed. Sec.L.Rep., ¶94,869 (D.Del. 1974). See discussion, supra.

5. The defendants misrepresented that the WRG Board of Directors considered the Exchange Offer to be in the best interests of the Company to purchase its publicly held shares. No such resolution was adopted by the Board of Directors. See, Brief, supra, p.35; 558-563a.

6. The defendants failed to disclose that it was their intent to take whatever steps were required to attain private corporate status. See, Brief, supra, p. 43; 469a.

7. The defendants failed to disclose the circumstances and the nature of the "agreement" among the directors not to tender their shares. See, Brief, supra, p. 36; 447-448a. Gould v. American Hawaiian Steamship Company, 331 F.Supp. 981 (D.Del. 1971).

8. The defendants failed to disclose that defendant Lawrence purchased 30,500 shares of WRG common in January, February, and March, 1974; that two other directors and officers purchased WRG common in July 1974; and that defendant Gibson purchased 1,000 shares on September 5, 1974, and did not intend to tender her shares.

9. The defendants failed to disclose the original acquisition of 301,000 shares by defendant Lawrence at 10¢ per

share, and such original acquisitions by other of the defendants and other officers, and the subsequent sales of such stock in the open market through the facilities of the Exchanges, and the total gains realized from those trades plus the gains on the two public offerings.

10. Failure to disclose that only 50,000 shares of WRG were ever publicly offered by the company itself.

11. Failure to disclose that WRG was given right in the Trust Indenture covering the debentures, to double the amount to be paid into the Sinking Fund in any given year. See, Prospectus, "Sinking Fund" (80a); White Weld letter Sept. 4, 1974 (357a).

It is submitted that the foregoing misrepresentations and omissions are material as a matter of law.

II

UPON THE APPLICATION OF THE STANDARDS FOR PRELIMINARY INJUNCTION, THE PLAINTIFF IS ENTITLED TO A PRELIMINARY INJUNCTION ON THE BASIS OF THE FACTS AND THE LAW INVOLVED.

The Court did recognize that "going private may "indeed raise serious questions concerning protection of the public interest." It was only on the misinterpretation of the law that Judge Carter did not apply the standard of sufficiently serious questions going to the merits and the balance of hardship tipping decidedly in the direction of the plaintiff and the class. The plaintiff did meet both standards: Likelihood of success on the merits and irreparable injury; and serious questions and balance of hardship.

CONCLUSION

It is respectfully submitted that this Court should grant a preliminary injunction enjoining the balance of the scheme and device, by enjoining any further acquisition of any WRG common stock through any direct or indirect purchases by any of the defendants, or through any merger or other form of retirement of the presently outstanding WRG stock in the hands of the public, pending final determination of this action.

Respectfully submitted,

NEMSER & NEMSER
Attorneys for Plaintiff-Appellant

Stanley Nemser
Norman S. Nemser
Peter Wang
Of Counsel.

ADDENDUM A

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

RICHARD C. ALBRIGHT, for himself and for and on behalf of all other persons similarly situated, Plaintiffs, vs. GLORIA MARSHALL BERGENDAHL, ALLAN BERGENDAHL, SIDNEY H. CRAIG, INTERNATIONAL SERVICE INDUSTRIES, INC., a Utah corporation, BODY CONTOUR, INC., a California corporation, and TOUCHE ROSS & CO., Certified Public Accountants, a partnership, Defendants.	MEMORANDUM DECISION Civil No. C74-135

The Motion of Plaintiff and the Class for Summary Judgment was heard by the Court on August 22, 1974. Counsel for all parties were heard and their arguments duly considered. The Court has before it the uncontroverted Affidavit in Support of Motion for Summary Judgment of the Plaintiff, dated July 19, 1974 and the various attachments and exhibits to that Affidavit, the SEC S-14 Registration of Gloria Marshall, Inc. and a certified copy of the

Articles of Incorporation, amendments and related filings of International Service Industries, Inc.

The Court finds from two proxy statements mailed through the United States Mails in 1974 to the plaintiff and the class, that the transaction outlined in those statements constituted the "purchase" or "sale" of a security, namely, the Common Stock of defendant International Service Industries, Inc., within the language, meaning and intent of Rule 10b-5, 17 CPR 240.10b-5; that defendants Gloria Marshall Bergendahl, Allan Bergendahl and Sidney H. Craig caused to be formed in early 1974, a new California corporation, viz., Body Contour, Inc.; that these defendants with the substantial assistance of defendant Touche Ross & Co., caused defendant International Service Industries, Inc. to be merged with and into defendant Body Contour, Inc. in April, 1974. The Court further finds that this merger was a "freeze out" wherein defendants Gloria Marshall Bergendahl, Allan Bergendahl and Sidney H. Craig were to receive capital stock of Body Contour, Inc. while the public stockholders of International Service Industries, Inc. were to receive 18 cents per share cash only, with no opportunity to receive Body Contour, Inc. stock as the defendants granted to themselves. The Court holds that such a transaction, under these facts and these circumstances, constituted a "device, scheme or artifice to defraud" or an "act, practice or course of business which operates

or would operate as a fraud or deceit" upon the public minority stockholders of International Service Industries, Inc. On this holding, the Court finds the reasoning of Judge O'Kelley of the North District of Georgia in Bryan v. Brock & Blevins Co., 343 F. Supp. 1062 at 1068-70 (1972) and of the Court of Appeals for the Fifth Circuit in Bryan v. Brock & Blevins Co., 400 F. 2d 563 at 569 (1974) pursuasive on this point. The Court further holds that such conduct constitutes a breach of their fiduciary duties of these defendants to the public minority stockholders of International Service Industries, Inc. On this holding, the Court finds the reasoning of the United States Supreme Court, Mr. Justice Douglas speaking for a unanimous Court, in the 1939 case of Pepper v. Litton, 308 U.S. 295, at 306-12, compelling and appropriate to the case at bar. (Both the District Court decision and the Court of Appeals decision in the Bryan case quote and rely on Pepper v. Litton: 343 F. Supp. at 1068, 490 F. 2d at 570.) Defendants' counsel contended that summary judgment should [illegible] be entered if a single genuine issue of fact remained unresolved or in dispute. The Court concurred with that reading of Rule 56. The Court invited defendants' counsel to advise the Court of any genuine issue of fact remaining for disposition. Counsel for defendants advised the Court that one such issue remained, *viz.*, whether the merger of International Service Industries, Inc. with

and into Body Contour, Inc. served a "legitimate corporate purpose". The Court is of the opinion that, given the facts and the circumstances, and, in particular, the absolute dominance and control of these defendants of and over International Service Industries, Inc. and the duties to these defendants (see Pepper v. Litton, supra, at 311) the plaintiff does not have the duty of negativing a "legitimate corporate purpose". If and to the extent that the Court of Appeals' decision in Bryan, supra, differs from that of the District Court in Bryan, supra, on this point, the Court agrees with the District Court's interpretation. However, the Court finds that the sole purpose of the merger of International Service Industries, Inc. with and into Body Contour, Inc. was stated succinctly by these defendants themselves on page 2 of the "Supplemental Proxy Statement" dated March 29, 1974 (Exhibit B to Plaintiff's Affidavit dated July 19, 1974) under the heading of "Reasons for the Merger":

> "It is the belief of the Board of Directors that International Service Industries, Inc. is not a viable vehicle for the publicly held stock."

The Court finds that the reason or reasons stated by these defendants for the merger of International Service Industries, Inc. with and into Body Contour, Inc., under these facts and these circumstances, does not constitute a "legitimate corporate purpose"

but is manifestly an indirect attempt to accomplish what could not directly be accomplished lawfully, viz., the "freezing out" of the public minority stockholders. The Court, for the reasons and on the grounds stated above, holds that the plaintiff is entitled to an order of this Court voiding the merger of International Service Industries, Inc., with and into Body Contour, Inc.; for such damages, by reason of that merger, as shall hereafter be established and for the award of attorneys fees and costs as shall hereafter be determined.

The Court retains and reserves jurisdiction to consider class action processing, notice to class and the remedy or remedies to be hereafter fashioned by the Court to achieve the effective enforcement of the applicable federal securities laws and the duties of corporate fiduciaries in this action.

DATED this 5th day of September, 1974

/s/ WILLIS W. RITTER
WILLIS W. RITTER
Chief Judge

ADDENDUM B

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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

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UNIVERSITY CAPITAL CORPORATION, :

Plaintiff, :

v. : 74 Civ. 4460

BARBARA LYNN STORES, INC., et al., :

Defendants. :

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BEFORE: HON. EDWARD WEINFELD,

District Judge.

October 25, 1974 - 3:15 p.m.
New York, New York

PRESENT:

KASS, GOODKIND, WECHSLER & GERSTEIN, Esqs.,
Attorneys for Plaintiff,
By: STUART D. WECHSLER, Esq.,
of Counsel.

SHEA, GOULD, CLIMENKO & KRAMER, Esqs.,
Attorneys for Defendants,
By: SHELDON D. CAMHY, Esq.,
of Counsel.

ljkmch

DECISION OF THE COURT

THE COURT: Plaintiff moves for a preliminary injunction to enjoin consummation of a merger between Barbara Lynn Stores, Inc., and Lynbar Corp., both Delaware corporations. In effect, the relief sought at this point is to delay the filing of a merger certificate, the plaintiff apparently recognizing that the merger can be consummated. The shareholder meeting to vote on the merger set for November 1, 1974.

The defendants are Barbara Lynn Stores, Inc., Lynbar Corp., and the stockholders of Lynbar, its directors, and also directors of Barbara Lynn.

The complaint alleges (1) violations of Section 10(b) and Section 14 of the Securities and Exchange Act of 1934, in that material misstatements and omissions were made in the proxy soliciting shareholder approval of the proposed merger, (2) that the merger is a scheme to defraud, and (3) that Barbara Lynn directors have breached their fiduciary duties.

Lynbar Corp. owns 43 percent of Barbara Lynn.

Now, I believe -- am I correct? -- that the original 43 percent was owned by individual stockholders and transferred to Lynbar.

MR. CAMHY: That is correct, your Honor.

THE COURT: By the terms of the proposed merger

all Barbara Lynn shareholders, other than Lynbar, will receive $4 a share for their Barbara Lynn stock. If the merger is approved, which, as I have already indicated, is likely in view of the fact that Lynbar will vote its 43.8 percent holding in favor of the merger, and approval of the merger requires a simple majority of Barbara Lynn shares, plaintiff and others similarly situated will be required to surrender their shares for $4 per share or seek appraisal under the Delaware Corporation Law.

As the proxy statement indicates, Lynbar was created by directors of Barbara Lynn as a corporate entity to hold their shares of Barbara Lynn stock. It has no other business or assets. The creation of Lynbar and the proposed merger is for the purpose of enabling the insiders of Barbara Lynn to buy out the public stockholders of Barbara Lynn and return to the status of a private, rather than a publicly-held, corporation.

The use of the corporate forms is for the purpose of facilitating this repurchase of Barbara Lynn stock. It is assumed a merger was agreed upon as the best way to accomplish this, as once the merger is approved all public shareholders of Barbara Lynn are bought out at the set price of $4.

Most of the plaintiff's allegations charge that

the $4 merger price is inadequate and a fraud on the public shareholders of Barbara Lynn, primarily because the net current asset value per share of Barbara Lynn is greater than $4 per share, being $7.70 per share -- I think that is the right figure. Is that the figure you had there?

MR. WECHSLER: I think it's $7.85, your Honor.

THE COURT: Well, either $7.70 a share or $7.85.

Given full and adequate disclosure, the question of what is a fair price for the stock is not a question for the Court to decide. It's a question for the shareholders of Barbara Lynn to decide. Armour & Company v General Host Corporation, 296 F. Supp. 470, 475 (S.D.N.Y. 1969); American Crystal Sugar Company v. Cuban American Cane Sugar, 276 F. Supp. 45, 50 (S.D.N.Y. 1967).

However, in order to have an adequate and informed judgment, full disclosure is required. While, as I have stated, plaintiff makes various allegations of misstatements or omissions in support of its application for injunctive relief pending a trial, most of these appear, at least at this stage of the proceedings, without substance. But, as I indicated during the course of counsels' argument, one charge in particular appears to be of some merit. This is particularly so since the controlling shareholders of Lynbar who own 43.8% of Barbara Lynn's stock are directors of

both corporations, and therefore in a position of conflict of interest. Thus, their every action should come under the closest scrutiny, even though that conflict has been acknowledged and specifically referred to in the proxy statement. This is particularly so since it is acknowledged that the directors in large measure acted upon the basis of an expert's opinion. The Court is referring specifically at this time to the so-called Whitman opinion, which evidently played a major part in the judgment of the directors.

According to the proxy statement, "Mr. Martin J. Whitman" -- I am quoting now from the statement -- "an independent financial consultant, with experience as an expert in evaluation of companies engaged in retail and discount store operations, was retained by Barbara Lynn to recommend a cash merger price that would in his opinion be fair and equitable to the public stockholders of Barbara Lynn. On July 15, 1974, Mr. Whitman expressed his written opinion to the board of directors of Barbara Lynn that a cash exchange price in a range between $3.75 and $4 per share in the merger would be fair and equitable to the public stockholders of Barbara Lynn. The merger price was determined by the boards of directors of Lynbar and Barbara Lynn in reliance on such opinion.

"Mr. Whitman indicated his opinion took into

account various factors which he deemed relevant including, among others, stock market prices and trading volumes of Barbara Lynn stock, comparisons of Barbara Lynn with other companies engaged in similar activities; the December, 1973 block purchase of Barbara Lynn stock at $4-7/8 (See "Information About Lynbar - principal stockholders of Lynbar" on Page 13); an analysis of cash purchases of securities by other publicly-owned corporations in recent months; the operating results and outlook for Barbara Lynn; the Company's financial condition; and current industry conditions."

Counsel upon the argument of this motion referred to the fact that there was before the board of directors an opinion, an opinion of this expert which it was not necessarily required to be submitted to stockholders. However, it does seem to me that if the board of directors acted on Mr. Whitman's judgment, which was based upon factual material contained a separate document (according to counsel's statement), then the shareholders were entitled to this information.

For example, when it is stated that "he took into account various factors which he deemed relevant, among others, stock market prices," what were the factors he took

into account? What were the comparisons with other companies? Which were the companies he compared Barbara Lynn with? What was the analysis of cash purchases of securities by the companies, and what were the operating results? What was his projection for Barbara Lynn and current industry conditions?

I think that once having made reference to this opinion, the shareholders were entitled to it and I hold that it was a material omission not to submit the information to them.

Also, there is the failure to set forth in the proxy statement full information, readily discernible, as to the net asset value per share before and after the merger.

Counsel stated that aggregate figures are set forth, but they are set forth in such a way that it would seem to me it would require an investment expert or one trained in the securities field to really compute this matter, and there is no reason given why this wasn't set forth in the proxy statement.

Since the meeting will go ahead on November 1st, weighing the likelihood of success - and I believe on this factual situation there is a likelihood of success -- the balance of hardship favors the plaintiff in this case, parti-

cularly since there would be no injury or harm to the defendant if the filing of the papers consummating the merger are held up for two weeks following the date of the merger meeting, which is November 1st. Accordingly, the motion is granted and the defendants are enjoined from filing the papers consummating the merger for a period of two weeks from Nov. 1st. The parties, of course, particularly the defendants, are free to apply for an immediate trial on the issues raised by the complaint, so there will be a full disposition on the merits.

MR. CAMHY: Your Honor, I'm advised that this is assigned to Judge Metzner, and I somehow received the impression, which may be erroneous, but I'm saying it because I can't verify it at the moment, I have been told that he has been put into some heavy major trial, public trial of some kind.

THE COURT: Then you apply to Judge Metzner, and Judge Metzner will refer the case to the assignment committee and it will be assigned to another judge, if that is the fact.

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MR. CAMHY: Your Honor, should I consider your decision the equivalent of an order to make a supplemental disclosure on the Whitman report?

THE COURT: I would think that you ought to make a supplemental disclosure in the meantime. There is nothing to stop you from doing it, and you will bring your position up to date if and when the case goes to trial. You would have the benefit of a full disclosure and then you can raise this issue that you do raise of fair price. There is nothing to stop you from making disclosure now.

MR. CAMHY: Thank you, your Honor.

THE COURT: Now, if you want an order entered on this, if you want to go up on appeal, you enter an order on it, whatever you want. All I said to the reporter, before it's released, I want to go over it and make whatever corrections there are on it and then you can have it at that time.

MR. CAMHY: Your Honor, I thought I understood your Honor, but several of my partners have a question, that is, as I understand it, your Honor views the Whitman report as appropriate and in effect directs that it be sent out as full disclosure to meet --

THE COURT: I'm not directing you to do it. I'm

holding, on the papers before me, that it should have been sent out, and I'm saying that there is nothing to stop you from sending it out. I'm not directing you to send it out. I have simply granted an injunction which prevents you from filing papers consummating the merger. I'm not enjoining the merger meeting from being held on November 1st.

Now I think what I said is perfectly clear.

MR. CAMHY: Thank you, your Honor.

THE COURT: What you are asking me for, apparently your associates here want me to direct you to send it out, and I'm not doing it. You are free to do it on your own.

Now, do you all understand that?

MR. CAMHY: Yes, sir.

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SERVICE OF THREE (3) COPIES OF THE WITHIN APPELLANT'S BRIEF, PURSUANT TO STIPULATION DATED JANUARY 14, 1975, IS HEREBY ADMITTED.

DATED: JANUARY 14, 1975

Hughes Hubbard & Reed

HUGHES, HUBBARD & REED
Attorneys for Appellees